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Politics this week

Nov 14th 2002
From The Economist print edition

Resolution of sorts

AP

Iraq accepted the resolution on disarmament the United Nations Security Council passed unanimously last week. The Iraqis said it was a bad resolution, and claimed to possess no forbidden weapons, but accepted it without conditions. The first UN inspectors are due to arrive in Iraq on November 18th.

See article: Saddam says yes

Jordan's army took over Maan, a southern town, in pursuit of Muhammad Shalabi, a local cleric they want to interrogate regarding the recent murder of an American diplomat.

See article: Crackdown in Jordan

A **Palestinian gunman** killed five people, including two children, in a kibbutz in Israel. The Israeli army reoccupied the West Bank city of Nablus and raided Gaza.

See article: Reprisals and politics

A tape claiming to feature the voice of **Osama bin Laden** was broadcast by al-Jazeera, a satellite-TV station in Qatar.

See article: The voice of Osama?

Students and others demonstrated in Tehran after judges in **Iran** passed a death sentence on Hashem Aghajari, an academic who had proposed a Shia Muslim reformation. Ayatollah Ali Khamenei, the supreme leader, called fruitlessly on all factions to end their feuding.

See article: Iran's struggle for reform

Driss Jettou, **Morocco's** new prime minister, announced a 31-member government, including nearly half the outgoing coalition, leaving an Islamist party as the only big opposition faction.

Meles Zenawi, Ethiopia's prime minister, gave warning that his country faced a **famine** worse than that of 1984 if food aid was not increased.

See article: Hunger in Ethiopia

The Convention on International Trade in Endangered Species, meeting in Santiago, Chile, voted to allow Botswana, Namibia and South Africa (but not Zambia or Zimbabwe) to conduct one-off sales of stockpiled **ivory**. Trade in ivory is otherwise forbidden. All five countries claim that their elephant populations are secure.

Talking, at least

In **Venezuela**, President Hugo Chavez's government and the opposition agreed to start talks brokered by

the Organisation of American States and aimed at resolving the country's political deadlock.

See article: Crisis talks in Venezuela

AP

Argentina's President Eduardo Duhalde admitted that a presidential election due in March might be postponed. He blamed a judicial ruling; others claimed that Mr Duhalde wanted more time to prevent his arch-rival in the Peronist movement, Carlos Menem, a former president, from returning to power.

See article: Argentina's political struggle

Remaking Cyprus

The UN presented a peace plan for **Cyprus** to the Greek-Cypriot and Turkish-Cypriot leaders: essentially one “common” state comprising two “component” states, roughly Swiss-style. Turkey's new strongman, Recep Tayyip Erdogan, sounded not unfavourable to the idea.

See article: A breakthrough over Cyprus?

Russia and the European Union struck a deal, to come into force next summer, enabling residents of the Russian enclave of **Kaliningrad**, on the Baltic Sea between Poland and Lithuania, to have “facilitated travel documents” (ie, easily acquired visas, in all but name) letting them travel easily to and from Russia proper.

Britain's government faced a wave of strikes by firemen demanding a 40% pay rise. Tony Blair seemed determined to resist for now.

See article: Public sector strikes

New forecasts showed **Germany** facing stagnation if not renewed recession. Chancellor Gerhard Schröder, re-elected only two months ago, saw his Social Democrats fall to 14 points behind their conservative opponents in opinion polls.

See article: Germany's stumbling government

In a referendum called by **Gibraltar's** government, over 85% voted, and 99% of those who did rejected the idea of joint sovereignty put forward by the Spanish and British governments.

Silvio Berlusconi, **Italy's** prime minister, said he would end an 11-month stint as his own foreign minister. Franco Frattini, currently the civil-service minister, was tipped for the job.

EPA

In **Florence** a huge rally—as much against war in Iraq as earlier targets such as globalisation—ended a five-day gathering of the European Social Forum. The government had feared that there would be trouble but the demo passed off almost without incident.

See article: An Italian row about globalisation

The **Dutch** Labour Party, routed in May after eight years of power, chose a new leader: 39-year-old Wouter Bos.

Near Calais, mainly Kurdish **asylum-seekers** occupied a church in protest at France's closure of the Sangatte centre, the former base for those trying to slip into Britain by train. French police removed them after a five-day stand-off.

A heavy blow

AP

At least 36 people were killed by a series of unusually severe **tornadoes** in the United States.

See article: The twisters return

Congress moved close to a deal to forge a **Department of Homeland Security** out of 22 agencies. Democrats accepted that its 170,000 workers should not have full union rights.

See article: Politics as usual in Washington

Senator Dean Barkley of **Minnesota**, who was appointed to replace Paul Wellstone for the remainder of the current Congress, said he would vote as an independent. This leaves the Democrats in control of the Senate for a few more days until Jim Talent, the new Republican senator for Missouri, is sworn in.

Long-awaited parliament

Pakistan's President Pervez Musharraf called for the country's newly elected parliament to convene on November 16th, ending weeks of delay. The pro-Musharraf party, which won the most seats in the October elections but not a majority, was expected to make a deal with an Islamic grouping.

On the first anniversary of the fall of the Taliban regime in **Afghanistan**, students demanding better living conditions clashed with police. Two people died.

See article: Women in Afghanistan

Indonesian police said a man named Amrozi, from East Java, had confessed to being one of a gang that bombed the nightlife district of **Bali** in October, killing 190 people.

See article: Bali arrests

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Business this week

Nov 14th 2002
From The Economist print edition

Hanging on

Vodafone, the world's biggest mobile-phone operator, reported strong first-half results. Pre-tax profits were up by 41% compared with a year ago to £4.25 billion ($6.1 billion); debt fell by some £1.3 billion to £10.7 billion. Vodafone's shares jumped by 13%.

Cable & Wireless woke up to its global ills. It reported a loss of £4.5 billion ($6.8 billion) for the six months to the end of September and announced that 3,500 jobs would go at C&W Global, its troubled corporate-data and web-hosting business. Investors, hoping for a more drastic re-organisation, sent the company's shares down by 36% to their lowest level since 1984.

Deutsche Telekom announced a loss of *euro*24.5 billion ($24 billion) for the first nine months of 2002, after writing off some *euro*20 billion. The telecoms giant also picked a new boss, Kai-Uwe Ricke, an insider whose father once ran the firm. He is a permanent replacement for Ron Sommer, who left earlier this year.

See article: The rise of the virtual network

Swiss blues

Credit Suisse, Switzerland's second-biggest bank, announced a record loss of SFr2.1 billion ($1.4 billion) for the third quarter. It also hired Leonhard Fischer, ex-Dresdner Kleinwort Wasserstein, to run its troubled Winterthur insurance arm.

UBS, Switzerland's biggest bank, announced that it would do away with the PaineWebber and Warburg names, bringing both investment banking and retail stockbroking under the UBS brand; it will take a charge of SFr1 billion ($689m) in the fourth quarter for the pleasure. It also announced a modest 4% increase in profits for the third quarter compared with a year ago, to SFr942m.

See article: Investment banks

Allianz, Germany's biggest insurer, reported a *euro*2.5 billion ($2.5 billion) loss for the third quarter, its worst ever. Its recently acquired bank, Dresdner, was responsible for almost *euro*1 billion of the loss.

See article: German life insurers on the rocks

HSBC Holdings, Europe's biggest bank, agreed to pay $14 billion in shares for Household International, an American consumer-finance company, to boost its presence in North America.

Does not compute

Hewlett-Packard's shares tumbled after news that Michael Capellas, number two in the company behind Carly Fiorina, would leave. Investors fear that Ms Fiorina may struggle to run HP while it is in the throes of implementing its merger with Mr Capellas's old firm, Compaq Computer. Mr Capellas is set to take over at WorldCom, where he will try to drag the company out of bankruptcy protection after a big accounting scandal.

See article: Carly's on her own

Jac Nasser re-entered the job market after getting the push from Ford a year ago. He will become a partner at Bank One's private-equity arm, One Equity Partners.

William Webster stepped aside as head of America's new accountancy-oversight board, following the departures of both Harvey Pitt as chairman of the Securities and Exchange Commission and Robert Herdman as the commission's chief accountant. Both had strongly backed Mr Webster in an acrimonious selection process that had split the SEC.

See article: In need of new blood

Wal-Mart, the world's biggest retailer, made a record profit of $1.8 billion in the third quarter. But there are signs that American shoppers may spend less; consumer confidence is waning.

Bad medicine

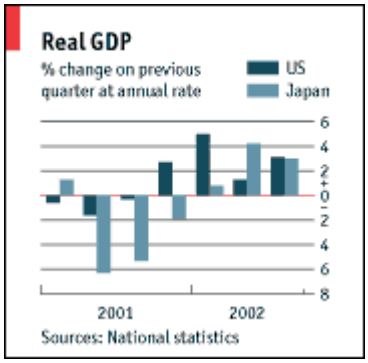
Bayer, the German chemicals group that invented aspirin, said that it was prepared to relieve itself of a headache: its drug division. It announced profits of *euro*656m ($645m) in the third quarter, a marked improvement from losses a year ago caused by the withdrawal of Baycol, an anti-cholesterol drug. That and other product failures are leading Bayer to seek to sell a majority stake to another big drug company.

Corus pulled out of a £2.8 billion ($4.4 billion) merger with **CSN**, Brazil's biggest steel maker. The Anglo-Dutch steel company cited business “uncertainties” for its decision to abandon the deal. The company also warned of heavy losses in the second half.

Disharmonisation

A European **single market for financial services** could increase growth in the EU by at least 1.1%, according to a study by the European Commission. However, the goal of achieving a single market by 2005 looks fanciful given the bickering and foot-dragging by member states that has characterised progress so far.

The pace of **Japan's recovery** from recession slowed. The economy grew by 3% in the third quarter at an annualised rate compared with 4.2% in the previous quarter. That, and other signs of a weakening economy, sent the Nikkei 225 stockmarket index near to a 20 year low.



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America and Iraq

Now reel him in

Nov 14th 2002
From The Economist print edition

Even in the unlikely event that Saddam disarms, a taut line will still be needed

Get article background

AP

BY BEING plainly willing to use force, George Bush has put Saddam Hussein on the end of a hook from which even this serial prevaricator may now be unable to wriggle free. Last week's unanimous resolution from the Security Council presents the Iraqi dictator with a stark choice. On the face of it, he must either give up the illicit weapons of mass destruction (WMD) for which he has made Iraq pay so much in sanctions since 1991, or face the near-certainty of an American-led invasion and his own political if not physical extinction. It is possible, if Saddam understands his position, that war can be averted and Iraq can be swiftly defanged. But there remains ample scope for miscalculation. And even if he complies fully with the new resolution, thereby ending the immediate crisis, Saddam's long duel with America will not be over.

Make my day

As is his wont, Mr Hussein spent half the week keeping the world guessing. Would he submit to the new resolution, which orders him to give up WMD and let the UN's arms inspectors return? His “parliament” urged him not to, on the ground that the resolution is no more than an American-inspired pretext for an invasion. But he is enough of a survivor to know that an outright rejection would simply make such an invasion inevitable. So on November 13th, Iraq wrote to the UN accepting the resolution. The question now is whether this “yes” is really a “yes but”. And even if it is a yes, will Saddam repeat the cheating that stopped the inspectors from disarming Iraq last time they tried (see article)?

Cheating will be a lot riskier now. Never before has an American president looked as willing as Mr Bush does to send an army into Baghdad. Henceforth, there is to be “zero tolerance”: Mr Bush has promised to discuss any Iraqi transgressions with the Security Council, but insists that America will make war alone if the council refuses to act. In the past, Mr Hussein has been a shrewd exploiter of differences between the council's permanent five. This time, too, some members are liable to take a more indulgent view than others of “minor” Iraqi infractions. Who is to say whether they are minor or major? Much will depend on the verdict of Hans Blix, the inspectorate's head. But in the end, as Mr Hussein must know, it is Mr Bush's finger, not the UN's, which is on the trigger.

What is more, it is a hair trigger. To comply with the resolution, Saddam has until December 8th to give a “full and complete” declaration of his illicit WMD holdings. If he sticks to the line in this week's letter that he has none to declare, and if the inspectors can show that he is lying, the Americans may feel entitled to invade even without waiting for Mr Blix's full report. If Saddam declares only a part of what he is concealing, he needs to be certain that no foreign intelligence service can guide the inspectors to something he has left out. The safest way for him to save his head is therefore to make a clean breast of everything. But that would be doubly painful. What could be more humiliating for this martyr-hero than to admit that he had been fibbing all along, and was coming clean now only at the point of an American gun? And

Semi-compliance, followed by a new rift in the Security Council, is an all too probable outcome. In that case, Mr Bush should stick,

how bitter to give up the weapons for which, under the sanctions, he has been willing to forgo well over $150 billion since 1991.

literally, to his guns

For these reasons, Mr Hussein's full compliance cannot be taken for granted. Semi-compliance, followed by a new rift in the Security Council, is an all too probable outcome. In that case, Mr Bush should stick, literally, to his guns. He has never based his case for war mainly on the need to uphold the council's already ragged credibility. The strong case (stronger too than the unproven link between Iraq and al-Qaeda) is that letting a Saddam get his hands on a biological or nuclear bomb is simply too big a danger to the world. But now that the Security Council has offered Saddam this sombre “final opportunity”, its credibility really is in peril. If Saddam pokes even half a finger in the world's eye, Mr Bush will deserve the Security Council's support when he resorts to war, especially from those members who have lately made such a song and dance about America's tendency to act alone.

And if he submits?

Arguably, the harder decision for America is how to react if, against all precedent, Saddam does now swallow his pride and submit without demur to the council's will. In that case, Mr Bush should eventually be willing to declare victory and call off his threatened invasion. Saddam's survival would no doubt be galling to many in America, which since well before the election of Mr Bush had made “regime change” in Iraq its official policy. And it would be tragic for most Iraqis, who have suffered too long under this unusually violent dictator. Nonetheless, once Iraq was certifiably WMD-free, the balance of risks and benefits would tilt strongly against removing him by force. That is all the more the case given Mr Bush's decision to work through the Security Council. As the co-author of the resolution that gives Saddam this last chance to repent, America has both a duty to honour its own word, and—if it is to be taken seriously in future—an interest in doing so. Even if Saddam survives, Mr Bush could be justly proud of a policy that ended with the non-violent disarming of Iraq.

Good if war can be avoided now. But this time, let there be no dropping of the guard later

As for Saddam, he will be a much diminished figure if he emerges from this duel defanged and humiliated. But he has endured humiliation before, notably after his trouncing in Kuwait in 1991, and gone on to rebuild his power. His advantage in such contests is that he is fixated solely on his own survival. The world moves on, but he remains the same Saddam. After 1991, America had so much business elsewhere—the end of the Soviet Union, the reunification of Germany, war in the Balkans—that it relaxed its grip on Iraq. It dare not repeat that mistake. One or five years hence, Americans may no longer feel as ready as September 11th has made them at present to wage war in the Arabian desert. When oil has made Iraq rich again, who is to say that an unchastened Saddam will not revive his dream of turning Iraq into the nuclear-armed superpower of the Arab world? Good if war can be avoided now. But, this time, let there be no dropping of the guard later.

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Britain's universities

On the road to ruin

Nov 14th 2002
From The Economist print edition

There's a solution to the disaster of Britain's universities, if only the government had the courage to grasp it

Get article background

BRITONS have got used to decline. They do not expect to see their country wield much economic clout, political influence or military power these days. But they still retain intellectual pretensions: they tend to think that, even if they aren't much good at turning cleverness into cash, they can match any other nation for inventiveness, culture and sheer brains.

If that isn't already an illusion, it will be soon. Britain's universities, the nurseries of the next generation's brains, are being ruined, and the government is doing nothing to stop it. Its long-promised review of university finance was put off from last year to this; then it was expected to be published this month; now it is billed for sometime next year.

It is easy to put off addressing the problems of higher education. When firemen go on strike, people get burned. When lecturers go on strike, students get to stay in bed longer. But, as Lord Baker said in a speech on the subject last year, “when great institutions decline they do not suddenly fall over a precipice, they simply slide down the slope, a little further each year, in a genteel way, making do in their reduced circumstances, like a spinster in an Edwardian novel.” He should know: as education secretary in the 1980s, he was in part responsible for the disaster.

They forgot to pay

Labour and Tory governments of the past four decades have agreed that higher education should no longer be enjoyed only by a small elite, but should be available to the masses. Accordingly, successive governments raised the proportion of teenagers going to university from 5% in 1960 to 35% now. But they failed to fund this expansion properly. Instead, in order to ensure that more students went through the machine at little extra cost, the government took more and more control of student numbers, the universities' income per student and thus the quality of education the universities could provide. So, at a time when nationalised industries were being privatised to allow them to raise more capital and respond to market signals, the universities were subjected to a system of centralised state management that allowed them to do neither. The consequences have been dreadful (see article).

Labour has failed to stop the rot. Student numbers, which levelled off briefly, are rising again, and Tony Blair wants 50% of 18-30-year-olds to get some higher education. The regularity with which the government promises, and then delays, its funding review, demonstrates that it regards the current system, and the alternatives, as equally dreadful.

The central question for a government trying to reform university funding is whether the taxpayer should bear most of the costs (as in Britain and elsewhere in Europe) or whether the individual should (as happens in America and, to some extent, in Australia). Placing the burden on taxpayers as a whole would be reasonable if it could be demonstrated that the benefits from one person's university education were felt mostly by society as a whole, rather than by the individual. But that does not seem to be the case. While the social

The answer is to cut universities loose from the state. Let them charge fees, as

benefits from higher education are debatable, the individual benefits are clear. Getting a degree makes you richer. According to the OECD, in Britain, university graduates earn around 17% more, on average, than non-graduates.

American universities do, and let the students pay

The answer is to cut universities loose from the state. Let them charge fees, as American universities do, and let the students pay. As well as shifting the cost burden from taxpayers to individuals, this solution would have three added benefits. First, it would help determine how many people should be going to university: Mr Blair's 50% seems to be drawn out of a hat, and some of those who think about education policy, such as Alison Wolf, professor of education at London University, doubt that his ambition makes economic sense. Second, it would bring more money into universities: America spends 2.3% of GDP on higher education, compared with 1.1% in Britain, and most of Europe's universities are in similar straits. Third, it would allow universities to manage themselves: the uniformity which Britain's centralised funding system encourages—with former polytechnics trying to be mini-Oxbridges—could give way to something more like California's system, where higher education ranges from short, cheap, vocational courses to a full-blown academic degree, and where universities and colleges have the freedom and incentive to specialise.

But the minimal (£1,100 this year, or $1,700) means-tested fees which the government introduced in 1998 were not popular, and the idea of raising them to anything like the levels needed to cover the cost of a student (£10,500 a year, says Imperial College) has aroused still more hostility. There are concerns, especially on the left of the Labour Party, that higher fees would discourage poor people from going to university. Rich kids' parents would pay, and poor children would find it difficult to borrow from banks to cover the costs of their tertiary education.

Access for all is an important issue; but a fees-based system can accommodate it. Australia introduced a state-run loans scheme to cover much of the cost of a degree. Graduates pay their loans back only if they earn reasonably high incomes, so students need not be put off by the fear of what happens if they don't get a good job. Since the new system was introduced in 1989, the social make-up of Australia's student base has not changed, which suggests that if carefully managed, fees need not put off the poor.

But aside from Labour's ideological worries about fees, raising them poses a political problem. Britain's middle classes are used to getting a free university education. Parents fear their children's pleas, especially when it may be pointed out that Sophie's mummy and daddy aren't mean enough to make her take out a horrid loan. And Labour fears the middle classes, who brought it to power, and who are getting increasingly grumpy as the tax burden rises.

No government enjoys making people pay for what they once got free of charge. But if Mr Blair does not opt for fees his grandchildren will not thank him. Institutions are easier to destroy than they are to build.

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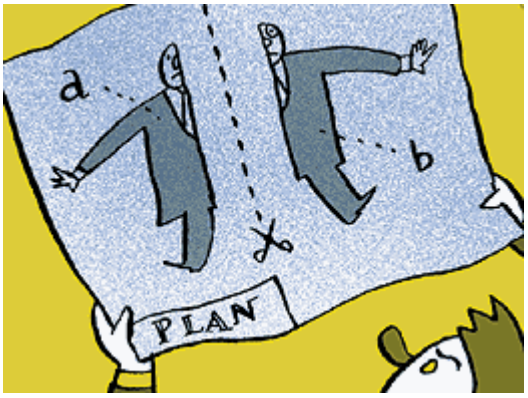
Investment banking

Redesign flaws

Nov 14th 2002
From The Economist print edition

Plans to re-regulate investment banking are wrong-headed



EFFORTS to clean up Wall Street are coming to a head. Regulators from New York and Washington are huddled in negotiation with the big investment banks over the final terms of an industry-wide settlement for all the allegations of abuses of investors and conflicts of interest that have been hurled at them over the past year. The most likely outcome is the imposition of a large fine on Wall Street firms, a greater separation of equity research from the investment-banking business, some commitment to finance “independent” research as well as the banks' own, and a change in the rules for allocating initial public offerings. Thus will the sins of the bubble years be washed away.

If all this sounds too good to be true, it is. There are two things badly wrong with any such settlement. The first is that it looks like an expensive and intrusive case of regulation that is unlikely to work. Attempts to legislate away conflicts in an industry that is so riven with them seem bound to fail. Chinese walls, however high, are always likely to fall at the first assault from deal-hungry bankers. It would be wiser for investors and issuers always to act on the assumption that conflicts exist.

Over the past two decades, financial deregulation has brought huge benefits, in the form of more competition, greater innovation and easier and cheaper access to capital. Rather than jeopardise any of these by re-regulating the industry, it would be more sensible to respond to past excesses by putting the emphasis on fuller disclosure. That would leave market forces to determine what kinds of intermediary are appropriate, how they should be structured and what they should earn. Indeed, the markets have already savaged the investment banks, which are fast slimming down and restructuring in response (see article).

The other objection to the planned settlement is how it is being reached. This may seem largely a procedural matter, but in fact it raises far more fundamental questions. The negotiations are being led by prosecutors, notably New York state's attorney-general, Eliot Spitzer, although a leaderless Securities and Exchange Commission (SEC) is at least at the table. Mr Spitzer is now trying to dragoon Wall Street firms into signing up to an early deal by threatening that, if they do not, he will reopen his investigations into potentially damaging e-mails and the rest. Yet if he or other law enforcers genuinely believe that crimes have been committed and laws broken, they should surely bring cases to court. If they do not, miscreants may escape punishment—and the suspicion will remain that what is really going on is a shake-down of the banks, not better protection of investors.

In any case, the odds are that a settlement cooked up in secret negotiation between Mr Spitzer and the big Wall Street firms will help them at the expense of smaller rivals. It would be better to debate changes in the structure and regulation of Wall Street openly, for instance in congressional hearings or before the SEC. Big banks can always afford to pay fines, higher regulatory costs or contributions to third-party research; smaller ones cannot. Investment banking is already overly dominated by established “bulge-bracket” firms, so much so that many companies complain of an underwriting cartel for new share issues. Indeed, this dominance may lie at the heart of the malfeasance that Mr Spitzer and his sort have uncovered. It would be a sad irony if supposed reforms ended up strengthening, not weakening, the bulge bracket's grip.

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NATO

Improve it, don't destroy it

Nov 14th 2002
From The Economist print edition

Ask more of NATO, but not too much

Get article background

DOES the most successful alliance in history have a future? At their summit in Prague next week, NATO's heads of government can decide to make theirs the indispensable alliance for the 21st century—or make it an irrelevance. Given the insults that have been flung across the Atlantic in recent months, about America's unilateralism and Europeans' wimpishness, you would think they might call it a day. But off-megaphone, and despite differences over Iraq (though these have divided Europeans from Europeans as much as Europeans from Americans), alarming new threats from instability, terrorism and the spread of weapons of mass destruction have led the NATO allies to a familiar conclusion: that their common security—even mighty America's—is better served by sticking together than by pulling apart. Still, with luck, what emerges from Prague will not at all be NATO as we knew it.

Since the threats these days, to Paris or Rome, Washington or New York, can come from anywhere, even reluctant venturers such as Germany now accept that NATO needs to be able to stray, not just nearby to the Balkans, but anywhere those threats may take it. Indeed, Germany has asked for NATO's help when it takes command with the Netherlands of the security force in Kabul next year. Yet a get-up-and-go NATO will have several obstacles and one potential minefield in its path.

Its biggest problems will be ones that dogged the old NATO: too few of the right capabilities, and too little cash to do much about it. A more expeditionary alliance will end up being just as hobbled as the old geographically bounded one without the ships and aircraft to move swiftly, and without the compatible and secure communications, smart weapons and greater numbers of special forces that would allow more Europeans, and not just Britain and France chiefly, to fight together more effectively.

Much will be made at the summit of the planned slimming of NATO's bureaucracy, and a proposed reorganisation of its flat-footed command structure. All well and good. But still AWOL will be the greater numbers of more readily deployable European soldiers needed for NATO's new mission. And it is not just America that misses them. The European Union is still struggling to put together its own promised rapid-reaction force, of 60,000 troops, supposedly deployable within 60 days and sustainable for up to a year. America has now proposed a smaller and swifter NATO response force of 20,000, ready to go in a sudden crisis. The two are not competitors; both have useful jobs to do. And all this is anyway the least that Europeans should be asking of themselves.

The holes in meagre defence budgets are at last becoming an embarrassment. Some groups of governments are considering pooling their cash: for strategic lift, air-to-air refuelling, and precision-guided munitions. Others, like Norway, are concentrating on special forces. But here looms the minefield. An alliance built on lots of specialisms will fast come unstuck unless all have confidence that the right ones will be there quickly in a tight spot. Germany's recent unilateralism—refusing any military help in disarming Iraq, even if asked by the United Nations—sets a worrying precedent.

Tread with caution

So, too, does America's insistence that NATO now scoop up as many new recruits as possible: most likely

Latvia, Lithuania, Estonia, Slovakia, Slovenia, Romania and Bulgaria. Some have more useful specialist capabilities than some of the old NATO crowd. Others could scarcely be trusted with a shopping list. America's vision is of NATO as the military hub of a network of relationships stretching through the Caucasus, Central Asia and beyond. Keep the vision, but stretch NATO itself too far and the glue will not hold.

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Space exploration

Too farsighted

Nov 14th 2002
From The Economist print edition

The dangers of too much vision

Get article background

AP

EARLIER this year, Tom DeLay, a Republican congressman from Texas, accused NASA, America's space agency, of having a “lack of vision”. He is not the first person to make this criticism and he certainly won't be the last. But what such critics actually mean is not that the agency has no vision—but that they happen to disagree with the one it has. In the case of Mr DeLay, his expressed dismay at the “anaemic” financing available for human space-flight was more a call of “Houston, we have a funding problem.”

Such accusations of a lack of vision should not sting NASA, because they could not be more wrong. For one thing the agency already spends the lion's share of its $15 billion annual budget on human space-flight. For another, if there is one thing that sums up what NASA has suffered from over the past three decades, it is too much vision, not too little. And the symptoms of this are most visible in the bloated, late, over-budget and largely useless human space-flight projects that it has been pursuing since the Apollo programme.

Vision express

After men landed on the moon, NASA needed to find something else to do, so it decided to try to put men on Mars. But Richard Nixon turned down this grand vision. And so, according to Roger Pielke, director of the Centre for Science and Technology Policy Research at the University of Colorado, Boulder, the agency simply broke the mission into three more easily sellable parts: the shuttle, the space station, and then Mars (see article). It was then left in the impossible position of having to justify each step on its own merits alone. This led both to the overselling of the shuttle and to the thin veneer of “science” that has been arranged around the space station.

It is true that science can be done in the space station. But science can also be done dressed in a clown suit atop a large Ferris wheel. The argument ought to be over where is the best place for it. Performing experiments in microgravity does not require a $100 billion platform. Moreover, much of the work that can genuinely be done only on the station is justified through another magnificently circular leap of logic. Research into the effects of microgravity on human health and the growth of soya beans, for instance, is useful only in the context of a manned mission to Mars.

The only good reason for NASA to be involved in human space-flight is to lay the ground for opening space up for everybody. It takes a vast leap of imagination to detect this reason in NASA's present strategy. Fleeting visits to the moon (or, one day, to Mars) would turn the agency into little more than an elite travel agent. But for decades there has been a huge pent-up demand for flights into space. Although the private sector is finally making some progress towards this, NASA should have been there years ago. What is still needed is research and development on economical and safe space transport for the public at large. Space, like the Wild West, can be truly opened up only by the private sector. NASA's central goal in human space flight should be to make that possible.

Until NASA swaps its destination-driven thinking for a science-based approach focused on such objectives, the post-1960 generation that has grown up hoping to travel or even live in space will

continue to feel betrayed. Several years ago, an organisation called the Space Frontier Foundation observed bitterly: “Thirty-six years after sending John Glenn into orbit, NASA has finally achieved the capability to send John Glenn into orbit.”NASA must find a more practical reason for the human space-flight programme. Sending people to eat all those soya beans cannot be it.

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Letters

Nov 14th 2002
From The Economist print edition

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Securing the knowledge

SIR – Just as there are economic cycles, the current push toward greater digital security that your survey (October 26th) considers is part of a recurring cycle in the history of technology. We regularly embrace the convenience of a new technology long before we deal systematically with its unwanted side-effects. The resulting convenience overshoot may last for decades: for example, the 40-year gap between the introduction of the Model-T Ford in 1909 and the widespread use of seat belts, or the 70 years between the introduction of steam locomotives in 1804 and pneumatic brakes. We first embraced the convenience of digital communications and only now are beginning to deal effectively with the new forms of assault that it allows.

Why do we keep making the same mistakes? Aeschylus explained it best some 2,500 years ago: “For Zeus, who guided men to think, has laid it down that wisdom comes alone through suffering.”

Jerrold Prothero
Dallas

SIR – You state that computer security requires that computer users maintain unique passwords of six to eight digits composed of strings of letters, numbers and other characters. Computers, as with all other devices, must be designed to take into account the abilities and proclivities of human users, and not impose impossible tasks on them. When users are asked for the impossible, they will usually find ways to circumvent those demands.

Linda Ikle
Pasadena, California

SIR – Your survey on digital security offers a heavily skewed view of the current state of the art in biometric technology. Apart from its use in airports, there are other valid uses of face-recognition technology that you do not address, such as the sifting of application data for passports or visas. Equally, your citation of recent Japanese research in the use of prosthetic fingers does little service to the more recent technical developments in biometrics (there are products resistant to these attacks in varying degrees) or to the obvious fact that there is a competitive market out there, where buyers are seeking value for money and fitness for purpose.

Calum Bunney
International Biometric & Authentication Consulting
Inverness

SIR – I am surprised that you attribute the security flaws in Microsoft software to “ubiquity” rather than its near-monopoly status. The true measure of Microsoft's market power lies in the lack of competitive pressure to fix the flaws in its products. That devoting more attention to security required an edict from Bill Gates rather than market pressure from dissatisfied customers only illustrates this point.

Phillip Saunders
Monterey, California

Little lives on

SIR – Your article on strategy consulting was highly misleading about Arthur D. Little ("Consultant, heal thyself", November 2nd). While Arthur D. Little did indeed seek Chapter 11 bankruptcy protection in early 2002, the management completed a successful buy-out of all Arthur D. Little operations in June 2002, including the global rights to the brand name, but with the exception of some businesses in America, which were sold separately. Today, Arthur D. Little is a growing and thriving consultancy with over 1,000 staff in 30 offices worldwide.

Richard Clarke
Managing director
Arthur D. Little
Cambridge

Bring Turkey into Europe

SIR – Ulf Bergstrom (Letters, November 2nd) asks "What benefit would sharing a border with the Middle East bring [to the EU]?" As a Turk who believes that Turkey belongs in Europe, I would answer that the first and greatest benefit of Turkey's joining the EU would be increased stability and security in the region. It would also set a good example for Middle Eastern countries in their endeavour to modernise their regimes and become democracies.

Emre Oskaylar
Warri, Nigeria

Nice move

SIR – Explaining the turn-around of Irish voters on the Nice treaty you omit to mention how the government changed the rules ("The Irish agree", October 26th). It took away the function of setting out the pros and cons from the neutral referendum commission. In Nice One, significant public money backed the commission's advertising, divided equally between both sides. For Nice Two, the government put through a law in December (in one day, with one day's notice to the opposition) that stopped this. This cleared the way for private advertising, which was overwhelmingly on the Yes side.

Moreover, the constitutional amendment to ratify the treaty was yoked to a clause about Ireland not joining an EU defence pact. This had nothing legally to do with Nice but it was only possible to answer Yes or No to the two propositions.

Anthony Coughlan
Trinity College
Dublin

Better educated

SIR – You rightly argue that the benefit of computers in education has been greatly exaggerated ("Screen it out", October 26th). Having dispelled one myth, you perpetuate another. You say that there is "good evidence" that spending more on smaller classes and better teacher training would improve educational performance. This is not what the evidence says.

Almost all the research suggests that reducing class sizes from the levels prevailing in developed countries today would yield little or no educational gain. The evidence on teacher training says the same. My own research, with Erich Gundlach and Jens Gmelin, (published last year in the *Economic Journal*) finds that despite a vast increase in real spending per pupil over the past 25 years in most industrial countries, there has been almost no improvement in student performance. What matters is not class size or teacher training but the incentives facing teachers, heads, students, parents and administrators. The preponderance of recent research is very clear about where the keys to success lie: in independent appraisal of student performance, school autonomy and competition among schools.

Ludger Woessmann
Kiel Institute for World Economics
Kiel

Russia must let go

SIR – You say that Russia's president, Vladimir Putin, is wrong to fear that if he lets Chechnya go other chunks would inevitably follow but you do not say why ("Losers, both", November 2nd). The answer is simple. A province of Russia is only likely to try to secede when it has a non-Russian border, a majority that sees itself as non-Russian and a major revenue-generating asset, such as oil. Of all Russia's provinces only Chechnya meets all three conditions. Its secession would not start the dominoes tumbling and is the only route out of the quagmire. Outsiders can help by pressing this point on the Russian leadership.

Robert Hunter Wade
London School of Economics
London

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Dealing with Iraq

Tick, tock

Nov 14th 2002
From The Economist print edition

Reuters

Time is running out for Saddam Hussein. And the new weapons inspectors will not tolerate his old tricks

Get article background

"THIS resolution assumes we have weapons." The deputy, indignantly addressing Iraq's parliament, was correct. The UN Security Council resolution does indeed assume that Iraq has weapons of mass destruction, and gives Saddam Hussein a "final opportunity" to get rid of them. Members of the parliament, hastily convened by their puppeteer to pour scorn on the resolution, obediently complained that the UN's demands impinged on Iraq's sovereignty. They are meant to. Mr Hussein had until November 15th to accept them. Two days before his deadline ran out, he said he would accept new UN inspections. He knew that failure to disarm would bring "serious consequences".

Iraq is hardly turning a new leaf. Mr Hussein's son, Uday, said that inspectors should be let in only if Arab experts were allowed to dog their heels. Hans Blix, the chairman of Unmovic—the UN inspectorate charged with overseeing the destruction of Iraq's illicit chemical and biological weapons and its banned missiles—is unmoved by that. He and Mohamed El Baradei, the (Egyptian, as it happens) director-general of the IAEA, the UN's nuclear watchdog, were due to arrive in Baghdad with an advance team on November 18th. Meanwhile, the clock is ticking. Iraq has 30 days from the adoption of the resolution on November 8th to produce a list of all its banned weapons and the technologies and materials that go into them, plus any civilian nuclear, chemical and biological programmes, even if it claims these have no military purpose.

But after eight years of blatant obstruction, and four without any access to Iraq at all, can new inspections succeed where previous ones failed? The barrage of Iraqi hostility suggests the inspectors will have their work cut out. Sceptics fret that Unmovic, with a roster of some 200 or so available inspectors, less than a third of whom have past experience in Iraq, will be no match for a regime so well-practised at deception.

But these inspectors will have three advantages: firmer backing, a clearer mandate, and tough new powers—all crafted to short-circuit the past pattern of Iraqi obstruction. The demand for a "currently accurate, full and complete" declaration of all Iraq's weapons of mass destruction is the key element. Like the original resolutions that ended the Gulf war, the new one puts the onus squarely on Iraq to disarm. But, one way or another, this time the obligation will be rigorously enforced.

The last set of inspections, which ended in 1998 when Iraq threw the inspectors out, provided plenty of lessons about the hazards involved—and how not to deal with them. The inspectors were never meant to play cat-and-mouse with Iraqi officials whose real assignment was to hide what they had. Yet the Security Council allowed Iraq to go on submitting one "full, final and complete" declaration after another, each a tissue of lies. As Russia, China and then France grew impatient for a return to business as usual, Iraq calibrated its increasingly brazen breaches of its obligations so that the council, in its increasingly divided state, gave it no more than a slap on the wrist.

Iraqi officials prevented inspectors from entering some sites, sometimes for days at a time, or kept them cooling their heels at the front gates as their minders "searched" for the keys—and the equipment they had wanted to inspect was trucked out of the back. Documents were withheld or confiscated, and production figures for some chemicals and agents were inflated to disguise hidden stocks of others. In some cases, the inspectors' physical safety was threatened: one Iraqi official seized the controls of a helicopter in mid-air to prevent inspectors seeing something they weren't supposed to see.

Under the new rules, patience will be short. Any "false statements or omissions" in Iraq's declaration, as well as any interference with or threats to the inspectors at work, will be considered a further "material breach" of its obligations and can be taken directly to the Security Council. Iraq has so far insisted that it has no weapons of mass destruction, even though the UN's own past inspections and reports from western intelligence services suggest that it has. Since any government is entitled to pass on tips about where to look, the inspectors should be able to tell quickly how well Iraq is co-operating.

Previous restrictions on access to presidential sites and other supposedly "sensitive" places have been swept away. Extra powers have been added to the inspectors' right to "immediate, unrestricted and unconditional access".

Charles Duelfer, deputy head of Unmovic's forerunner, has long argued that, if they had had 100 green cards to distribute, enabling key Iraqi personnel to testify in safety in America, inspectors could have quickly accounted for all Iraq's illicit arms. In the past, breakthroughs have come from defectors: after years of denials, Iraq partly owned up to an industrial-scale biological-weapons programme only in 1995, when Mr Hussein's son-in-law, who ran the hidden programmes, fled abroad (he later returned to Iraq and was killed).

Iraq's arsenal

Nuclear/radiological

Not known to possess facilities to produce fissile material in sufficient amounts for nuclear weapons
Would require at least several years and extensive foreign assistance to build such fissile material production facilities, but may have acquired some uranium-enrichment capability. Has also sought "significant quantities" of uranium from Africa
Could probably assemble nuclear weapons within months if fissile material were obtained from foreign sources
Has previously experimented with radiological weapons. Could divert domestic civil-use radio-isotopes or seek to obtain foreign material for a crude device

Biological

Many tonnes of growth media and agents from pre-1991 stocks unaccounted for
Capable of resuming agent production on short notice from existing facilities; could have produced thousands of litres of anthrax, botulinum toxin and other agents since 1998
Production of viral agents, possession of small-pox unknown. Has experimented with camel pox

Chemical

Some 4,000 tonnes of chemical precursors and perhaps 750 tonnes of VX precursors from pre-1991 stocks unaccounted for
Capable of resuming production on short notice from existing civilian facilities; could have produced hundreds of tonnes of agent (mustard and nerve agents) since 1998. Some weapons deployable "within 45 minutes"

Delivery means

Has probably retained a small force of up to 20 650km (400 mile)-range al-Hussein missiles
May have produced some al-Samoud missiles, with ranges up to 200km
Capable of manufacturing rudimentary chemical and biological warheads. Some pre-1991 munitions still unaccounted for
Capable of delivering biological weapons with simple airborne wet-spray devices; development of more advanced devices for wet spray or dry agents unknown

Sources: IISS; UN; SIPRI; intelligence reports

Others have claimed that work continues on nuclear weapons; the British government says Iraq has sought "significant quantities" of uranium in Africa, and the IAEA admits that these might be hard to find in Iraq. Several defectors have told of Iraq's efforts to hide germ and chemical production beneath private homes and hospitals, and to develop mobile germ labs. Inspectors therefore now have the right to interview anyone they choose, without minders present and, if necessary, abroad. They can also demand that Iraq halt all land and air traffic near a suspicious site, to prevent the removal of incriminating evidence.

And if the council goes soggy again? Mr Blix has made it clear that its firm backing is the inspectors' best means for obliging Iraq to disarm. The UN's secretary-general, Kofi Annan, insists that, if Iraq fails to take this last chance, the council must "face its responsibilities". And reopening rifts in the council would not help Mr Hussein this time. The inspectors' own not-so-hidden weapon is the knowledge that, if he tries to cheat on regardless, nothing in the new resolution the council has passed requires its formal approval for the use of force against him. America and some of its allies stand ready to complete the job; and America's policy, says the national security adviser, Condoleezza Rice, will be "zero tolerance" of Iraqi transgressions.

A united Security Council, at least so far as its arm has been twisted by America, and a tightly-fashioned set of obligations may yet persuade Mr Hussein to give up his weapons—or claim to. At that point, the inspectors' task will be to show that the disarming is done credibly. Their new powers will help. But ultimately it is not the power of the inspectors, but the resolve of those who back them up, that counts. Mr Blix's job, as he points out, is to report. It is for the council itself—or else others—to decide what happens if Iraq will not co-operate.

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The Arab response

Pragmatism's victory

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From The Economist print edition

America's will is not to be resisted

Get article background

ON NOVEMBER 10th, the foreign ministers of the Arab states declared their united opposition to armed action against Iraq. At the same time, they voted unanimously to endorse the new UN resolution that could legitimise exactly that.

Gaps between rhetoric and realism are not unusual in Arab politics, but the matter of Iraq has made them wider. The spin put on the Security Council resolution in Arab capitals was that it was a victory for moderation. Wiser counsel had reined in a rampaging America, forestalled the immediate threat of war and given Iraq a chance to avert disaster. Unofficially, the near-universal view was that the UN had simply tightened the noose on Saddam Hussein, while getting the world to agree to close its eyes whenever America chooses to kick away the chair.

This is not a comfortable situation. Arab governments, by and large, detest Mr Hussein and resent his regime for continually dragging the region into unpleasant quandaries. Even so, they see more danger than benefit in pushing him to the wall.

Stalled economies, stale local politics, a sense of impotence in the face of America and seething anger towards Israel, have combined to put the “Arab street” in a very surly mood. The world's main case against Iraq, that it is failing to declare its weapons of mass destruction, simply does not bother the wider Arab public. Their rulers worry, understandably, that rising pressure on Iraq will be reflected in pressure from their own streets.

The unrest in the Jordanian city of Ma'an, for example, has been widely interpreted as a precedent for troubles elsewhere (see article). An Internet poll by al-Jazeera, the popular Qatari satellite-TV network, found three-quarters of the 25,000 respondents agreeing that Jordan's security crackdown was an attempt to pre-empt rioting in the event of war next door.

Beyond fears of popular unrest, the region's leaders remain sceptical of America's ultimate intentions. Talk by some American officials of “rearranging” the Middle East map, and praise for Israel's prime minister, Ariel Sharon, as a “man of peace” have won no friends among Arabs. Although a few Arab liberals are so sick of the region's stagnation that they might welcome a kind of Pax Americana, the vast majority want nothing of the kind.

Iraq also has other ties to its neighbours. In the past two years Baghdad has carefully cultivated business links to potentially friendly countries. The ten free-trade agreements it has signed are currently circumscribed by UN sanctions. Even so, Iraq's legitimate imports from Jordan, Egypt, Tunisia, Lebanon and the Gulf states now approach some $3 billion a year. Saudi Arabia, which has just opened a border crossing into Iraq, sealed a reported $380m in deals at this month's Baghdad International Fair alone. Many of these arrangements, it is believed, include kickbacks that enrich both Iraqi officials and well-connected foreign suppliers.

Outright smuggling has also proved a bonanza, particularly for cash-strapped Syria. Iraq exports at least 150,000 barrels of oil a day to Syrian ports which, assuming a 50-50 split in profits, may bring both governments some $50m a month in illegal income. In return, Syria is believed to act as a conduit for moving goods into Iraq. Sporadic intelligence leaks suggest that these include spare parts for its creaking armed forces.

The extent of this covert trade led many to assume that Syria, currently the only Arab state to hold a rotating seat on the Security Council, would vote against the new resolution. When it voted in favour, its diplomats hastened to explain that they had saved Iraq from a worse fate. They had removed “automaticity” from the text, extracting guarantees from Colin Powell, among others, that the resolution would not be used as an excuse for war.

These guarantees were not spelled out, however, and Syria was still criticised. Dawud al Shiryan, a Saudi commentator, said it was no surprise to see Syria join other countries, such as Sudan, Yemen and Egypt, whose media savage America as an aggressor even as their governments “fully co-operate with Washington on the political, security and intelligence levels.”

He might have added, but of course did not, that Gulf states, including Saudi Arabia, co-operate even more. America now has about 50,000 troops poised around Iraq, double the normal number, and is making use of 18 major bases and dozens of secondary facilities spread across seven Arab countries.

Syria's flip-flop, then, confirmed the general Arab predicament. And the reason for it, say regional analysts, was simple self-preservation. America not only lists Syria as a “state sponsor of terrorism”, but makes it part of a “second tier of concern” after the axis of evil. Congress has debated a Syria Accountability Act, which would sanction the country for its presence in Lebanon and its support for Hizbollah, the guerrilla group. The administration has blocked this so far, but may not do so for ever. In the past year, Syria has managed to appease America by passing on intelligence about al-Qaeda. Now it may have built up its credit just a little more.

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America's Iraq policy

The quiet man's moment

Nov 14th 2002 | WASHINGTON, DC
From The Economist print edition

Colin Powell got his way

AP

His most important convert

Get article background

GEORGE BUSH is often accused of rushing into war with Iraq. His record hardly bears out the charge. Three months ago, officials in the White House were saying that the president had no need to seek congressional authorisation to declare war, had no need to consult the United Nations and should not give UN weapons inspections one last chance.

That he has, in fact, done all those things does not mean he has suddenly become a peacenik. But it suggests that the administration has, for the moment, decided that the UN is a useful way to ratchet up pressure on Saddam Hussein while Mr Bush wrestles with the question of what action, in the end, to take.

It also means that Mr Bush has thrown in his lot with the multilateralists in his administration, led by Colin Powell. Last week's UN resolution was a triumph for the secretary of state. Before it, hawks in the administration had argued that the costs of going to the UN would be too high. America, they argued, knew what needed to be done: Saddam had to go. The UN would, at best, postpone his eviction, and at worst would keep Saddam and his weapons in place.

In the event, as Mr Powell may well have argued, the resolution leaves America better off than it was before in all but one of the likely outcomes of the confrontation. If Mr Hussein attaches any sort of conditions to his acceptance of the resolution (something that was not yet clear as *The Economist* went to press), or obstructs the inspectors, or is caught lying, the matter will go back to the Security Council. But the question of what constitutes a “material breach” of the resolution is so clearly laid out in the document itself (which all 15 members, including, most vitally, Syria, have accepted) that there is limited scope for debate on that point; and if the Security Council disagrees about the need to respond to such a breach with the use of force, America can still act alone, as it is fully prepared to.

If Iraq's dictator were to comply entirely with the resolution—an eventuality few people can imagine—America could disarm him without military action. Mr Bush himself appears to accept that full disarmament would be tantamount to “regime change”, because Saddam without weapons is not Saddam. Only if Mr Hussein lets the inspectors in and manages to fool them for months will America be worse off than it was before the UN vote.

The administration's war plans, apparently leaked this week, were also something of a success for Mr Powell. They suggest that the Pentagon intends to use a small force of soldiers to encircle Baghdad quickly, while keeping 250,000 troops ready in the region to counter resistance. If genuine, they reject the contention of some hawks—though not the hawks inside the administration—that a limited high-tech operation would suffice. Although they assume that Mr Hussein will fall quickly, they accept that there may be prolonged fighting afterwards. At this point, the well-known Powell doctrine—that America should not engage in war unless with overwhelming force and a strategy to get out again—would come into play.

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The lame-duck Congress

Trent's and George's big adventure

Nov 14th 2002 | WASHINGTON, DC
From The Economist print edition

Reuters

Congress reconvened for business this week still stunned by the Republicans' triumph in the mid-term elections. It may well get a lot done

Get article background

"TODAY, I'm working for the Senate majority," says one puzzled Democratic staff member. "Who I'll be working for when I get back from lunch, I have no idea." His confusion reflects a wider sense of uncertainty in Washington. This week Congress waddled back into town for a "lame-duck" session—one that takes place after an election has changed party control but before the change has been implemented, so that the *ancien régime* remains in charge. This time, though, even that seems to be in doubt.

Minnesota has a new senator for the brief session—an independent called Dean Barkley (otherwise known as Senator Footnote), who was appointed after Paul Wellstone's death. Had Mr Barkley chosen to vote with the Republicans, he could have shifted party control—and Trent Lott could have become the majority leader immediately. Instead he chose to remain as an independent, leaving the Democrats in charge. But only for another week or so: as soon as Missouri's votes are certified, the Republican, Jim Talent, will take his seat immediately, without waiting until early January like other newcomers.

When the lame-duck session was expected to last only three days, the exact timing of Mr Lott's ascension seemed to be another footnote. Now it appears that the lame duck could unexpectedly fly.

Its first order of business is to pass a budget: 11 of the 13 bills that finance the government have not been agreed upon. No one thinks all 11 can be passed now, so the post-election session will simply keep the government going next year under this year's budget.

Far more important, the lame duck now seems likely to quack through the biggest reorganisation of government since the 1940s. This is the creation of a new Department of Homeland Security, gathering under one umbrella 22 of the agencies responsible for domestic safety. The sticking point has been the opposition of Senate Democrats to provisions allowing the president to bypass civil-service restrictions in hiring, firing and redeployment.

The election ended that stand-off. On the campaign trail, George Bush lambasted Democrats for

obstructing the bill, and afterwards called it “the single most important item of unfinished business”. He demanded a bill to sign before the end of the old session. Meanwhile, the Democrats are now desperate to hang on to a Senate seat in Louisiana, where Mary Landrieu, the Democratic incumbent, faces a run-off on December 7th. Many Democrats believe that their candidate in Missouri, Jean Carnahan, lost to Mr Talent partly because she was left vulnerable to the charge that her party was insufficiently vigorous in defending homeland security.

The Democrats' leader in the Senate, Tom Daschle, still opposes the deal. But this week three centrist senators—two Democrats, one Republican—agreed to a slightly revised White House plan giving the president the flexibility he wants to be able to fire people, while allowing civil servants a right to appeal. The House has now passed the compromise bill.

At the same time, the insurance industry thinks that a terrorist-insurance bill could pass, allowing the federal government to share losses from terrorist attacks with insurers. And both parties have said it might be possible to pass a bankruptcy-reform bill. If all that goes through, the “pointless” lame duck could end up passing almost as much legislation as all the preceding sessions of this Congress.

But the bigger question concerns the next session. Will the administration use its newly established control of all branches of government to push through an ambitious conservative agenda? Or will it restrain its more partisan members and seek to govern from the centre?

At the moment there is not much doubt about Mr Bush's preference for moderation. He has been careful not to claim a broad mandate from the mid-term elections and is busy scaling back expectations of further huge tax cuts and another round in the “culture wars”. Last week, for example, Mr Lott told a Christian radio network that he wanted to ban “partial-birth” (late-term) abortions. White House officials poured cold water on the idea, and Mr Bush said he wanted to pursue two or three issues at a time—in other words, to proceed cautiously and incrementally.

The question is whether he can actually do that. The mid-term elections have hugely increased his authority over the party. On the other hand, he will come under pressure from conservatives like Mr Lott and the assertively ideological Tom DeLay, who has just become the House majority leader. And the president is seeking Senate approval for his judicial nominees, some of whom have views (on abortion, among other matters) that could alarm non-conservative voters.

Fiscal policy is another battleground. Making the 2001 tax cut permanent (it expires in 2010) remains a priority, and will surely be enacted (though its short-term economic impact will be minimal). Beyond that, signals are mixed. Some Republicans say that, if the economy remains weak, there should be some sort of stimulus package next year. That could include an immediate increase in the child tax credit, higher contribution limits for tax-preferred retirement accounts or a possible acceleration of parts of the Bush tax cut. That agenda seemed to get a boost when Mr Lott replaced Pete Domenici, the top Republican on the Senate Budget Committee for 22 years and a well-known deficit hawk, with Don Nickles, a conservative senator much keener on tax cuts.

On the other hand, Paul O'Neill, the treasury secretary, gave a warning this week about long-term fiscal problems and played down the idea of a big stimulus. Other officials are working on bigger proposals (such as reducing the double taxation of dividends) as well as fundamental reform to the tax system itself, though that could be for the very long term.

The best bet must be that Mr Bush will get his party to fall in behind a cautious, “small-bang” agenda. But it is not yet clear what that agenda will be, or how strong the pressures from Messrs Lott, DeLay and the conservative wing of the Republicans will be to expand it.

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Osama bin Laden

Still there?

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From The Economist print edition

An audiotape one had definitely hoped not to hear

Reuters

He may look different now

DEAD or alive? The world seems to have its answer. On November 12th al-Jazeera, a Qatar-based television network, broadcast an audiotape purported to have been made by Osama bin Laden. The tape is being analysed by voice-recognition experts. But American officials strongly suspect it is authentic.

The tape praises a string of recent terrorist acts, including the bombing in Bali, the hostage-taking in Moscow and, most recently, the shooting of an American diplomat in Jordan on October 28th. It promises retribution for military action in Iraq. It includes Mr bin Laden's trademark historical references: he compares George Bush to a “modern-day Pharaoh” and Dick Cheney and Colin Powell to “Hulega of the Mongols”. And it warns westerners: “You will be killed as you kill, and will be bombed as you bomb. And expect more that will further distress you.”

Until now, the last definitive sighting of Mr bin Laden dates to videotapes he made in Afghanistan in December 2001. If it is him, Mr bin Laden has abandoned his normal preference for videotapes—perhaps because he was disfigured in Afghanistan, perhaps because he has deliberately changed his appearance, perhaps because he wants to avoid giving any clue as to his whereabouts. But, if it is genuine, the tape suggests, at the very least, that he can still get his message across.

This is a setback for the war on terrorism, not least because Mr bin Laden's right-hand man, Ayman al-Zawahiri, also still seems to be alive. The main aim of America's campaign in Afghanistan was to destroy al-Qaeda and obliterate its leaders. Mr Bush claimed that he wanted to smoke Mr bin Laden out of his hole and capture him “dead or alive”. Many people quietly hoped that Mr bin Laden had either been killed in Tora Bora or had succumbed to kidney disease. The tape may help those critics of the Bush administration who argue that America is making a mistake in taking on Saddam Hussein before it is finished with al-Qaeda.

Peter Bergen, the author of “Holy War, Inc” (Free Press, 2001), a book on al-Qaeda, says that Mr bin Laden's pronouncements (which are rare, and carefully stage-managed) are reliable guides to his actions. They normally not only signal a new wave of attacks, but also provide some clues as to what those attacks will be like.

In 1998 he issued a *fatwa* urging Muslims to kill Americans, “soldiers and civilians alike”. This was followed by the bombings of the American embassies in Kenya and Tanzania. In early 2000 he issued a videotape in which he wore a Yemeni dagger. This was followed by the sinking of the *USS Cole* in Yemen. In the summer of 2001 he issued another videotape in which he urged his supporters to capitalise on their achievements in Yemen and attack more American targets. This was followed by the atrocities on September 11th.

The most noteworthy thing about the audiotape is that it directs al-Qaeda's wrath against all of America's allies, not just America itself. Mr bin Laden mentions six countries—Britain, France, Italy, Canada, Germany and Australia—as well as fulminating against “crusaders” in general. Tony Blair, Britain's prime minister and Mr Bush's staunchest ally in the war on terrorism, has said over the past few days that the level of terrorist threat in his country is unusually high.

Worse, people are now beginning to think that another audiotape, which came out in October, may be genuine. That singles out economic targets. This seems to be a pattern with al-Qaeda these days (a recent audiotape by Mr al-Zawahiri also mentioned them), and one reflected in recent terrorist activity. The attacks on a French oil tanker and on a nightclub in Bali were directed at two gigantic businesses: oil and tourism. Economic targets are much easier to hit than America's heavily fortified embassies. They also have the advantage, from the terrorists' point of view, of widening the fear.

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Why the Republicans won

All white on the night

Nov 14th 2002 | WASHINGTON, DC
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An initial verdict: white Republicans turned out, black Democrats didn't

WHO voted Republican in last week's mid-term elections? The question may seem odd, but because the Voter News Service (an exit-polling consortium run by broadcasters) collapsed on polling day, the answer is that we do not yet know for sure. But the bits and pieces of evidence available all point to one answer: whites voted in huge numbers and account for George Bush's victory.

The only large statewide poll taken that day was in California, by the *Los Angeles Times*. It showed white voters accounted for 76% of the electorate, up 12 points from the previous mid-term poll in 1998. That was a sharp reversal of previous trends (and something of an electoral embarrassment). Whites, who make up less than half the state's population, had seen their share of the vote decline in the past decade.

Fox News, a broadcaster, conducted a series of smaller polls in ten battleground states, which showed a similar pattern, albeit less marked. On its numbers, the white share of the vote rose nine points above its 2000 level in Florida, five in Colorado and four in Missouri.

This rise in white turn-out goes a long way to explaining the Republican victory. Again, harder evidence will have to await official calculations by the Census Bureau. But according to a poll taken on the eve of the election by the Gallup organisation, whites favoured Republicans by no less than 20 points (58% to 38%). They had also supported Mr Bush over Al Gore in 2000 (though by only 54% to 42%).

This tentative conclusion—heavy white turn-out won for the Republicans—gets further confirmation from county-by-county returns. Democrats managed to hold their strongholds in cities and inner suburbs. But they were swamped by Republican majorities in rural areas, small towns and “exurbs” (rich counties on the fringes of metropolitan areas).

Minnesota is an example. Walter Mondale held the traditionally Democratic Twin Cities of Minneapolis and St Paul. He also won the “iron range”, the old industrial and mining area of the north-east. But his Republican challenger, Norm Coleman, racked up big majorities in the rural south-west and in Anoka and Dakota counties, on the edges of the Twin Cities. That won him the race.

The pattern held good in Georgia, explaining the upset there. Roy Barnes, the Democratic governor, did slightly better in Atlanta (Fulton and DeKalb counties) than he managed in 1998. But turn-out in all-white Forsyth county rose from 20,000 to 32,000, while in largely-white Cherokee county it went from 31,000 to 41,000. The Republican, Sonny Perdue, won both counties easily.

Interestingly, the Republicans had not previously imagined that white voters would be so crucial. Matthew Dowd, a pollster for the White House, had argued his party needed to get 13-15% of the black vote and 38-40% of Latinos to get a majority. In fact, Republicans won only 24% of the Latino vote in California (barely more than in 1998); in New Jersey they took 26% (down from 2000) and in Texas about 35%—not bad considering a Latino was running for governor as a Democrat but less than Mr Bush's share in 2000. Only George Pataki in New York achieved Mr Dowd's Latino target. As for blacks, Steve Sailer, who has trawled through the numbers for United Press International, reckons that the Democrats increased their already high share of the black votes cast.

The problem for the Democrats was that so few blacks and browns bothered to turn out. In California, where Gray Davis spent millions on get-out-the-vote drives, the Latino share fell from 13% in 1998 to 10% this year—the first decline since 1986. The black share plummeted from 13% to just 4%. In ten of the 11 states where there were exit polls, the black share of the vote was lower than in 2000.

The notion that blacks and Latinos, who are supposed to be part of the Democratic base, might be lukewarm supporters is a much more terrifying idea for the party than any of the disappointments on the Republican side. If you also consider that the Democrats failed to persuade whites to vote for them, you can readily understand why the party's managers are so glum.

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Megan's Law

A scarlet letter

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Are sex offenders being punished too bluntly?

AP

A label for the rest of his life

AFTER leaving prison, murderers, armed robbers and drug dealers can re-enter society as reformed individuals. Sex offenders, on the other hand, are marked for life. “Megan's Law”, a federal law enacted in 1996 and then approved by every state, requires America's 386,000 convicted sex criminals to register their whereabouts with the police, who in turn inform the public. In certain states, such as California, you have to go to a police station to find the list; but some 30 states have put their lists on the Internet, sometimes with accompanying pictures and street-maps. In many states, the police are also required to go door-to-door to warn people when a high-risk former sex offender moves in.

The law, named after Megan Kanka, a young girl killed by a former sex offender, is enormously popular in America (and anxious parents in other countries, including Britain, have tried to copy it). But civil libertarians still argue that sex offenders are being unfairly singled out. On November 13th, two appeals decisions—one from Alaska, the other from Connecticut—were argued before the Supreme Court.

The basic issue remains the appropriate balance between the rights of sex offenders and the safety of everyone else. The two cases, which won their lower-court decisions, do not question the constitutionality of a database of sex criminals (it has survived countless tests already). Rather, they target the way the information is spread.

The Alaska case claims that the statute violates the *ex post facto* clause, because it punishes offenders who finished their sentences before the law was passed. The two anonymous plaintiffs insist that they have been rehabilitated and pose little risk of re-offending. In one case, the disclosure of a man's former incest would humiliate his present wife. They maintain that placing such details on the Internet, where anybody can see them, amounts to further punishment. The state of Alaska says it is just disseminating public information.

The Connecticut case is a class-action lawsuit against the state's Internet registry. The plaintiffs argue that, because the state's database makes no distinction between high- and low-risk offenders, it stigmatises all former convicts—without giving them the chance to defend themselves. Why should a 17-year-old convicted on statutory rape charges for having a consensual sexual relationship with a 14-year-old be placed on the same list as a serial rapist? The lower court agreed that the online registry was “too blunt” to be effective, and it has since been taken down.

Some 20 states may have to change their lists, if the Supreme Court upholds the case. But the Justices' sceptical questions seemed to indicate that they were reluctant to change Megan's Law. Most Americans have few qualms about singling out sex offenders for special treatment. The law was partly inspired by Minnesota's Jacob Wetterling law, passed in 1991, which also targeted sex offenders. Few politicians want to tamper with a law named after a dead or missing child.

The common assumption that sex offenders are likelier to re-offend than other sorts of criminals is not necessarily borne out by the statistics. Recent figures are hard to come by. But those for people released in 1994 show that by 1997 only 78 (or 2.5%) of the 3,138 rapists released from prison had gone on to

rape again. Meanwhile, one in five of those released after serving sentences for assault and murder had attacked another victim.

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The sniping trial

The tough state gets it

Nov 14th 2002 | RICHMOND, VIRGINIA
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Who executes wins

AP

Muhammad may never leave Virginia

THE legal argument between the federal government and the states of Maryland and Virginia over which of them will prosecute John Allen Muhammad and John Lee Malvo, the two men accused of last month's sniping murders around the nation's capital, has been won by Virginia. This is where local prosecutors have the best chance, if the pair are found guilty, of getting the death penalty for Mr Muhammad and his teenage companion, who are linked to ten killings in the Washington area last month, and perhaps another five before that elsewhere in the country.

Virginia, which has in recent years executed more people than any other state except Texas, also allows capital punishment for people as young as Mr Malvo, who is believed to be 17 years old. Maryland, where Mr Muhammad and Mr Malvo allegedly killed six of their victims (twice as many as in Virginia), currently has a moratorium on the death penalty. And neither Maryland nor the federal government would have been able to execute Mr Malvo because both prohibit the death penalty for minors.

Mr Muhammad and Mr Malvo will face two different prosecutors (or, as they are known here, Commonwealth's attorneys). Mr Malvo will stand trial in Fairfax County, a wealthy, cosmopolitan suburb of Washington on the other side of the Potomac river. The county's prosecutor, Robert Horan, who has had the job for 35 years and is known as “The Bull”, caused riots in Pakistan when he offered a cash reward in 1993 for information about two fatal shootings outside the headquarters in Virginia of the Central Intelligence Agency. The Pakistani national convicted of the killings was due to be executed this week in Virginia by lethal injection.

Mr Muhammad, who is 41, will be tried in Prince William County, a blue-collar and still rather rural area. Its prosecutor is Paul Ebert—with 34 years in office, almost as long-serving as Mr Horan—who has sent 12 people to death row since Virginia resumed executions two decades ago.

Both Mr Horan and Mr Ebert are Democrats. This has not stopped other Democrats claiming that the Bush administration, by agreeing to have the trials take place in Virginia, is trying to help a Republican, the state's attorney-general, Jerry Kilgore, take back the Virginia governorship from the Democrats in 2005.

Although under Virginia law Mr Kilgore has little to do with prosecuting criminals—that is the job of local officials—he will play a role in the expected post-trial appeals. He will also have an opportunity to take a tough line on the death penalty, an issue on which his probable Democratic opponent, Lieutenant-Governor Timothy Kaine, is somewhat softer.

There remains, of course, the question of whether Mr Muhammad and Mr Malvo will be found guilty. This could be complicated in Mr Malvo's case by leaked reports that he has admitted to investigators that he took part in several of the attacks, and fired the shot that killed an FBI analyst who was out shopping with her husband. If Mr Malvo was interrogated without having his lawyer present, this might run foul of a constitutional right to counsel. The critics add that teenagers' confessions tend to be less reliable than older people's.

However, the prosecutors may have a trump card: a new, if still untested, Virginia law under which Mr Muhammad and Mr Malvo can be charged not only with murder but also with terrorism, for committing

acts of violence intended to threaten the public or the government. The law, a response to the terrorist attacks of September 2001, does not require the prosecutors to prove who actually pulled the trigger. That could be helpful.

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Politics in Chicago

King Richard's rivals

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The barons in Illinois are suddenly hustling him

EVEN crusty conservatives admit that Chicago has been transformed by Richard M. Daley. The Democratic mayor, who has been in office since 1989, wins kudos from corporate titans and green advocates alike for his vision, commitment and enthusiasm for everything from planting trees to luring Boeing. Indeed, he has done so well that at least some of the locals have stopped thinking about him as the son of Richard J. Daley, the legendary fixer who ran the city for 21 eventful years.

But as the original Daley would surely point out, passion, vision and the rest of it don't matter a jot without power. The current mayor, known as King Richard in some circles, has never been afraid to crack the whip. City workers scurry into their graffiti-buster vans whenever the mayor finds a defaced building. Aldermen on the city council have long been under the thumb of the Democrat-in-chief for fear of their political lives.

On the face of it, this month's near-sweep by the Democrats in the statewide elections was another victory for Mr Daley. Democrats have grabbed the governor's mansion (for the first time in three decades), the state attorney-general's office and plenty of other offices. But it is not so simple. The young governor-elect, Rod Blagojevich, who has been a fairly unremarkable congressman, may now dare to imagine that he, not Mr Daley, is the natural leader of the state's Democrats. Governors, however modest, seldom get on particularly well with pushier mayors from their own party: witness the battles between George Pataki and Rudy Giuliani in New York state.

Worse than this, both Mr Blagojevich and the new attorney-general-elect, Lisa Madigan, have family ties to other Democrats. Mr Blagojevich's father-in-law is Richard Mell, a powerful alderman on Chicago's north side. Ms Madigan's stepfather is Michael Madigan, the speaker of the Illinois House of Representatives. These puppet masters kept out of sight during the campaign, though that didn't stop the Republicans from claiming they were pulling the strings. On election night false modesty fell by the wayside, and both men planted themselves squarely behind their young kin on the victory platforms.

At a Chicago city council meeting the next day, aldermen lined up to congratulate Mr Mell as the mayor looked on. Then they voted themselves a pay rise, despite the city's tight budget. King Richard, who faces re-election next year, clearly has problems with the barons.

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The Pecos river

A lawsuit runs through it

Nov 14th 2002 | ALONG THE PECOS, NEW MEXICO AND TEXAS
From The Economist print edition

A river that is often barely a puddle encapsulates western water politics

BILL RICHARDSON, New Mexico's governor-elect, is now looking for a new state engineer, who will have the thankless task of trying to make water flow in a state that nature thinks of as a desert. The outgoing engineer, Tom Turney, has helpfully made the job seem more enticing by revealing that in his eight-year stint he has been sworn at, threatened and even beaten up. Few things symbolise the horrors of his job better than the Pecos river.

The Pecos, as even the Supreme Court has noted, is a complicated river. It starts simply enough in the Sangre de Cristo mountains as a bubbling stream. The villagers of Villanueva use the water according to customs dating back to the days when Nueva Mexico was under the Spanish crown: they divert it from a dam into an *acequia* or irrigation ditch, access to which is governed by their water official, or *mayordomo*. During Holy Week, everyone comes and clears the *acequia*. And during droughts such as the present one, they water gardens first, pastures last.

Downstream in Carlsbad, the same principle seems to hold. The farmland is fed, via an impressive, if leaky, aqueduct, with water that has run down from the mountains. The farmers also draw up ground water from the huge Roswell aquifer. Much of their water is stored behind dams, including one at Sumner Lake.

A peculiar feature of western water law is that, although the state built these dams, the water does not belong to everybody. “Priority in time shall give the better right,” the law says. The development of the Carlsbad area began in the 1880s, which means that, apart from ancient but small settlements like Villanueva, the Carlsbad farmers defer to no one in water matters. The whole flow of the Pecos river is theirs to use if they need it for their allotted acreage of water rights—the whole flow except the bit guaranteed to Texas, that is.

It is the 1948 Pecos River Compact that makes the river so complicated. In “High and Dry” (University of New Mexico Press, 2002), Emlen Hall, a law professor at the University of New Mexico, argues that the compact was the result of shrewd haggling and immature science. Central to the deal is the idea that the Pecos river should stay as it was in 1947. Each year, Texas is supposed to get the amount of water that the 1947 river would have released past the state line. A formula saying what that means is based on measurements of various inflows into the Pecos.

New Mexico has always found this bargain hard to honour. But it took Texas four decades to prove its case. In 1988 the Supreme Court finally decided that New Mexico had stolen $14m-worth of Texan water. It appointed a “river master” to enforce the 1947 formula.

Since 1988 the farmers of the Roswell Basin have dried up their act. The superintendent of the Pecos Valley Artesian Conservancy District, Dennis Karnes, can still remember sitting on a well-pipe as a boy and being launched into the duckpond as soon as the farmer opened the valve and natural pressure spewed several thousand gallons a minute of ground water against his legs. Now he points out that all the wells are metered, and, although the pressure has not returned to past levels, the Roswell aquifer is no longer over-used. The problem is that so far this does not seem to have raised the flow in the Pecos.

Some farmers argue that this proves they were not responsible for the missing water in the first place. But, from the perspective of the 1947 formula, this does not help anyone. Mr Turney thinks that New Mexico will miss its target this year by 10,000 acre feet (an acre foot is 326,000 gallons). His successor will face the dilemma of whether to shut off the Carlsbad irrigators to make sure that enough water can flow down to the Red Bluff reservoir in Texas. The state has also been buying up water rights in order to close down wells.

It seems strange that such drastic measures should be based on a formula from the 1940s that nobody believes is fair. The logical solution would be to update the formula, to take account of half a century's worth of hydrology. But the state that lost water, whichever it was, would inevitably block a new deal. Besides, a real attempt to redefine water rights might involve asking why farmers should get so much of the stuff in the first place.

Whatever water manages to get to Texas is destined for the town of Pecos, the last big farm community to use the river before it joins the Rio Grande. Pecos is famous for its cantaloupe melons—though these rely on groundwater pumps rather than the river, which is here no more than a few isolated puddles among the hubcaps and beer cans. But old animosities remain: the residents of Pecos know where “their” river has gone. Upstream, says Alvaro Navidad, who has come to look for rattlesnakes by the bridge, there's a place called Carlsbad, where they have a park, and the people there like to keep it green.

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The twisters return

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EPA

Seventy tornadoes tore through Louisiana and Pennsylvania over the weekend, destroying homes, flattening factories and killing 36 people. Of the 12 states affected, Tennessee was worst hit, with 17 dead; eight of these were in Mossy Grove, a small town almost wiped out by a mile-wide tornado. The storms were caused by a cold front moving into areas where temperatures had been unseasonably high.

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Lexington

A new face for the Democrats

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Cometh the hour, cometh the wrong woman

THE first rule of holes is: if you're in one, stop digging. An opposition party that manages to defy history by losing seats in a mid-term election is clearly in a hole. And what is the Democrats' reaction to their predicament? They're shovelling dirt like there's no tomorrow. As *The Economist* went to press, they were due to elect Nancy Pelosi to replace their retiring minority leader, Dick Gephardt. The Californian congresswoman's main rival, Martin Frost from Texas, has withdrawn his name. The only remaining challenger, Harold Ford, a 32-year-old from Tennessee, is putting down a marker for his future ambitions.

This is a disaster for the Democrats. Ms Pelosi will be responsible for shaping Democratic policy in Congress and selling that policy to the American people, an important enough job in any circumstances, but a pivotal one when the party is in turmoil. The Democrats' leading figures are slugging it out for the presidential nomination. Tom Daschle, never the brightest of stars, is duller still now that he has lost control of the Senate. Ms Pelosi, the first woman to hold such an exalted position in either party, is likely to be the public face of the Democratic Party.

Ms Pelosi has much to recommend her. The 62-year-old is clever, poised and telegenic—a mother of five who did not get into Congress until she was 47, but who has risen rapidly through the party's ranks, becoming minority whip this year. She is popular with her colleagues. She has only one defect—but it is a big one. She is a San Francisco liberal.

One of the clearest lessons of recent American history is that in a relatively conservative country the Democrats flourish when they move towards the centre—not just the political centre, but also the cultural centre. The likes of George McGovern and Michael Dukakis may have piled up landslide victories in Harvard and Manhattan. But they never connected with ordinary Americans. It took a southern governor with a taste for barbecue and a tolerance for Old Sparky to rescue the party from oblivion.

Ms Pelosi has a solidly left-wing record. She voted against giving the president war powers in Iraq, just as she voted against the Gulf war a decade ago. In 1996, she voted against welfare reform in the name of the poor (however, it has since helped to slash welfare rolls and reduce black poverty to historic lows). She also opposed Trade Promotion Authority, despite the fact that her own state's economy thrives on exports. You name it: wherever there is a hard decision to be made, Ms Pelosi can be counted on to come out on the fluffy side.

Ms Pelosi's problem has as much to do with culture as with politics. Mr Gephardt was hardly a New Democrat. But at least he represented blue-collar St Louis. San Francisco is wacky even by Californian standards, a city that voted for Al Gore by a margin of 61 points and that recently decided to allow city employees to have sex-change operations at public expense. San Francisco is home to the Ninth Court of Appeals, which voted to ban the phrase “under God” from the Pledge of Allegiance. Barbara Lee, the only member of Congress to vote against using force after September 11th, represents Oakland, just across the bay. The city spent less on its Veterans Day parade this Monday than it did on the Brazilian Holiday Carnival or the Samoan Flag Day. This is hardly the sort of place to fashion a moderate Democratic doctrine that can appeal to what San Franciscans refer to as America's “flyover territory”.

Ms Pelosi's defenders make two contradictory arguments on her behalf. The first is that she is not quite

the screaming liberal she might seem. She comes from a deeply pragmatic Baltimore political family and she has made her name serving on two of Congress's most bipartisan committees, intelligence and appropriations. She knows that her party needs to appeal to people other than trustafarians and tofu-eaters. The second argument is more or less the opposite: that there is nothing wrong with a leader who wants to fight for her side. Isn't the main job of the leader to charge up the party's base? Didn't Dick Gephardt represent the left of his party? And haven't the Republicans just made Tom DeLay the House majority leader?

Ms Pelosi is certainly more emollient in person than Mr DeLay. Who isn't? But she has made it clear that she believes that the Democratic Party's big default on November 5th was its failure to challenge the Republicans head-on. A lot of rank-and-file Democrats, bitter about their recent defeat, are keen to see some blows land on Mr Bush, and to pull Ms Pelosi to the left.

I left my majority in San Francisco

The danger in this approach is that it will bring short-term gains at the expense of long-term disaster. A more forceful criticism of Mr Bush's policies on Iraq and the economy may well galvanise the radical faithful. Ms Pelosi's friends in Hollywood may start to pour in money. The editorial pages of the *New York Times* may buzz with enthusiasm. The cloud that currently hangs over the party may temporarily lift. But the problem with galvanising the base is that you can alienate the silent majority.

Although Mr Bush clearly has an edge today, he is still a long way from securing victory in 2004. Ms Pelosi risks stranding the Democrats on the wrong side of Mr Bush's trump card—national security. Karl Rove, Mr Bush's Svengali, celebrated victory in the mid-term elections by ordering a march to the centre on everything from tax cuts to the culture wars. The more Congress is polarised between Ms Pelosi's liberals and Mr DeLay's hardliners, the more Mr Bush can pose as an embodiment of all-American common sense.

Ms Pelosi will eventually be obscured by the Democratic presidential candidate. The party could come to its senses and nominate a centrist. But, for a while, all eyes will turn to Ms Pelosi. Don't be surprised if Mr Rove is among the first to congratulate her on her new-found success.

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Argentina's collapse

The death of Peronism?

Nov 14th 2002 | BUENOS AIRES
From The Economist print edition

AP

Things ain't what they used to be for the political movement founded by Juan and Eva Peron, which risks permanent fracture

EDUARDO DUHALDE, since January Argentina's interim president, insists that he will stick to his self-appointed timetable and hand over power to an elected successor next year on May 25th, the country's national day. Yet it is not just his opponents who are starting to doubt his word. Last week, Mr Duhalde admitted that a presidential election scheduled for March 30th is likely to be postponed. The blame, he says, lies with a judge who has annulled his proposed electoral calendar. But much more is at stake.

Behind the argument over the election's timing lies a titanic struggle for control of what remains of Peronism, the emblematic political movement of modern Argentina. Founded by Colonel Juan Peron, a nationalist *caudillo*, and his charismatic wife, Eva, in the 1940s, Peronism has always been about leadership and patronage more than ideology. Though diminished, it still commands the support of perhaps a third of voters. Its grip on the lower orders of the Buenos Aires rustbelt has helped to ensure social peace, even as Argentina's GDP has shrunk by almost 15% following debt default and devaluation. It is one of the country's few remaining institutions—and it is fractured between Mr Duhalde, his bitter rival Carlos Menem, Argentina's president from 1989-1999, and half a dozen provincial bosses.

Mr Duhalde, installed by Congress after Fernando de la Rua was overthrown by protests, was originally due to govern until December 2003. Difficulty in obtaining political support for the measures required for a loan agreement with the IMF, and (so far groundless) fears of further protests led him to offer to bring forward his departure. But now, all is confusion. Even though an appeal court is likely to confirm the legality of the government's timetable, it is now almost too late to implement it. Having urged the courts to reinstate the schedule, Mr Duhalde has asked Congress not to approve it.

The confusion is not accidental. The only sure bet is that Mr Duhalde will do his utmost to postpone both a primary (now due in January) and an election while Mr Menem has any chance of winning either. The battle between them goes back years. Mr Duhalde was once Mr Menem's vice-president. But they collided over Mr Duhalde's own ambitions. Having helped block Mr Menem's attempts to stand for a third term in 1999, Mr Duhalde stood himself; he blamed his rival for sabotaging his campaign, letting in Mr de la Rua, of the opposition Radical party.

Polls have made Mr Menem a frontrunner, though with less than 20% of the vote. They also show that though most Argentines think Mr Menem partly responsible for their plight, they expect him to win. He still controls the party's executive, and might win a party primary. But Mr Duhalde has cobbled together

an alliance of several provincial factions, and is fighting back. Last week, at a party council, he was backed by around two-thirds of delegates, who voted to postpone the primary and to elect a new executive.

But Mr Duhalde lacks a candidate. His first choice would be Carlos Reutemann, the governor of Santa Fe province. But he has repeatedly declined. Several other Peronist hopefuls (including Adolfo Rodriguez Saa, president for a week last December, and another frontrunner) also appear reluctant to step in to the feud. Instead, they will probably run outside the party—the first time Peronism would enter a presidential election divided.

So one option under consideration by the president's men is to cancel the primary, and use an alternative system, whereby parties run several presidential candidates, with the two who collect most votes facing a run-off. Another is that Mr Duhalde stands himself. His aides believe his popularity could rise. They argue that the economy's long fall has at last stopped. They still hope for a long-awaited deal with the IMF. (However, it was not clear whether Argentina would make a big debt repayment due to the World Bank on November 14th.)

All this makes sense to Mr Duhalde and his followers. The Fund thinks differently. Beyond the fine print of the agreement, the delay in its approval is said to be due to the IMF's perplexity at Argentina's political confusion, and queasiness that any deal might boost Mr Duhalde, thus prolonging a government which has lacked the strength and will to take tough decisions.

Whoever wins this power struggle, unless and until Peronism unites under a new leader, or alternative political movements emerge, Argentina is likely to have a weak government. And that bodes ill for its chances of recovery.

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Recovery in Peru

Too good to last?

Nov 14th 2002 | LIMA
From The Economist print edition

Their country is doing quite well—but Peruvians don't think so

AP

Toledo feels the weight of responsibility

THE economy is growing at 4% and inflation is only 2%, a steady performance and one that looks almost spectacular compared with the rest of Latin America. Moreover, a decade of increasingly authoritarian rule has given way to the restoration of democracy and a few promising reforms. Given this, you might expect Peruvians to reward their president, Alejandro Toledo, by backing his allies in an election for the country's newly-restored regional governments on Sunday. You would be wrong.

After 15 months in office, Mr Toledo's approval rating stands at a mere 23%. And even that amounts to a revival: it was down to 14% in mid-October, until he at last plucked up the courage to recognise an illegitimate daughter and so resolve a paternity suit that had been damaging his credibility. Thus fortified, the president has spent this month touring the country, opening schools and roads and handing out computers.

Even so, his *Peru Posible* party is expected to be slaughtered in the election. Polls suggest that some regions will go to the opposition APRA party of Alan Garcia, a populist former president, but most to a motley collection of independents and local outfits. That is partly because of Mr Toledo's personal shortcomings. His wife, Eliane, has not helped: a Belgian-American anthropologist, she failed to declare that she was earning $10,000 a month as a consultant to a foreign bank. But Mr Toledo's problems also stem from the difficulty of satisfying popular expectations in a country where more than half are poor.

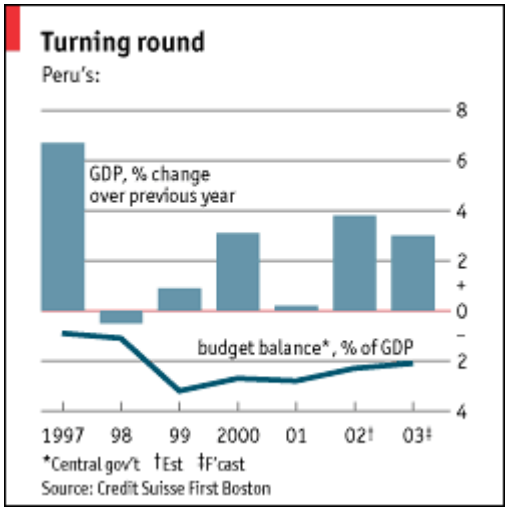
Mr Toledo owes his election to his stubborn campaign against the corrupt autocracy of Alberto Fujimori. He says he favours a market economy and liberal reforms—on some days, at least. But he is prone to rash promises, and to contradicting himself. Some Peruvians doubt whether he has the strength to resist a return to fiscal irresponsibility and demands for government meddling in everything from prices to tariffs. Those doubts are holding back private investment.

In June, Mr Toledo faced a popular rebellion in Arequipa, Peru's second city, after he broke a campaign promise by privatising two electricity firms. That revolt led to a cabinet reshuffle, and halted other privatisations. This has complicated the government's finances. Under Mr Fujimori, Peru fell into the habit of using privatisation revenues to pay for day-to-day spending. Now, the government faces a hole in its accounts (see chart) which it hopes to plug this year with a $500m bond issue. Next year looks more challenging.

The Arequipa riots were part of a broader wave of protests. Released from the grip of Mr Fujimori and Vladimiro Montesinos, his jailed spy chief, Peruvians have vented their frustration at several years of sluggish growth. Mr Toledo has appointed some capable ministers. But they have been forced into firefighting.

Take the interior ministry, where the new team launched an imaginative police reform. This involved sacking 620 senior officers tainted by the abuses of the old regime and trying to improve the work and conditions of those who remained. There are new offices

to handle both internal grievances and public complaints.



But Gino Costa, the interior minister, says that ambitious plans to modernise police stations and focus police manpower on tackling crime face two big constraints. First, the police force is tied down dealing with up to a dozen (often violent) demonstrations a day, providing security to dignitaries, or fighting drugs and the remains of Sendero Luminoso, a terrorist group. The second problem is lack of money. Pamplona Baja, a Lima shantytown district of 80,000, has only one police car. Most police stations lack computers. “When I visit, they ask for a new typewriter,” says Mr Costa. But 94% of his ministry's $750m budget is eaten up by wages and pensions. What money there is for new equipment comes from eliminating corruption, such as in buying petrol.

Escaping this vicious circle of poverty and discontent requires sustained growth. Mr Toledo's critics fear that by putting off economic reforms he has squandered the chance of that. But the economy has performed better than the critics forecast. And at least the opposition has no desire to overthrow the president. As an adviser to APRA's Mr Garcia puts it: “Any further erosion of Toledo would favour Fujimori,” still scheming in his refuge in Japan.

Memories of the hyperinflationary chaos of Mr Garcia's 1985-90 presidency have not died. “If Alan Garcia taught us something, it's macroeconomic principles. There is a consensus that there is a problem with the fiscal deficit. Many people have a great feeling of the country's precariousness,” says Julio Cotler, of Lima's Institute of Peruvian Studies. But that may not be enough to turn a democratic restoration into a full success.

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Modernising Mexico

Yes, ministro

Nov 14th 2002 | LONDON AND MEXICO CITY
From The Economist print edition

President Fox seeks inspiration abroad to reform a dysfunctional civil service

Get article background

IN BRITAIN this week for an official visit, Mexico's president, Vicente Fox, had lunch with the prime minister and tea with the queen. He opened a stunning Aztec exhibition at London's Royal Academy, and drew attention to some similarities between Tony Blair's policies and his own. To *The Economist*, he enthused about the use of private-public partnerships to pay for infrastructure projects (already being used for $20 billion of investment in energy in Mexico, he says). And if Mr Fox gets his way, a reform of Mexico's public administration, partly inspired by Britain's civil service, could become one of his most enduring legacies.

A civil-service reform law has already been approved by the Mexican Senate, and is now being picked over by the lower chamber. It forms part of Mr Fox's broader effort to democratise Mexico, after seven decades of rule by the Institutional Revolutionary Party (PRI). It is also one of the few areas in which he has not been handicapped by his lack of a majority in Congress, since he has won cross-party agreement for the change.

At present, except in the foreign ministry, there are no permanent federal-government staff above the unionised ranks of chauffeurs and porters. Each new minister can change every executive job in his ministry. Under the PRI, he often did. Different factions within the ruling party would spend a lifetime moving around the bureaucracy, according to the career moves of their leaders. There was no professional career structure. Rather, “public administration was a kind of booty for serving the PRI,” as an official puts it.

As a result, the standard of Mexico's public administration lags embarrassingly behind the rest of Latin America, let alone Europe or the United States. Corruption and incompetence are rife. To assure a peaceful transition, Mr Fox agreed to leave public officials in their jobs at first (though some say this has left his government open to undermining from within). Now he wants to create an independent civil service, with promotion based on merit rather than political patronage. “We are moving towards a more professional, less partisan, government,” he says.

The new law divides the jobs of 130,000 officials in the federal civil service into five grades, from director-general to clerk. All these posts will now be advertised. Controversially, their current occupants will have to re-apply for their own jobs. As in Britain, university graduates will be able to take a competitive exam to enter a “fast stream”. There will be new “individual performance evaluations”; those who fail could be fired. The aim is to avoid moving from a partisan administration to a moribund bureaucracy of jobs-for-life. Ministers will be able to hire political aides as special advisers, but—to separate the political from the purely administrative—the advisers will not be allowed to give orders to civil servants.

The bill may be approved next month, the blink of an eye by Mexican standards and an excellent advertisement for the consensus that has so far eluded Mr Fox in many other areas of reform.

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A mediator in Venezuela

Double games

Nov 14th 2002 | CARACAS
From The Economist print edition

Can negotiations bring political peace?

AP

A mob of constitutional lawyers

IT WAS a step back from the abyss of potentially violent confrontation—but only a small one. After a year of deadlock, the government of President Hugo Chavez and Venezuela's opposition finally began talks on November 8th. That in itself was a big achievement for Cesar Gaviria, the secretary-general of the Organisation of American States (OAS), who is chairing the talks. But gaining an agreement will be even harder.

Both sides seem to see the sessions as a chore: necessary to show their democratic credentials but unlikely to deliver what each wants. The opposition wants Mr Chavez, who claims to be leading a "Bolivarian revolution", to step down. It has asked the National Electoral Council (CNE) to organise a referendum on the subject. Otherwise, the opposition threatens an indefinite general strike to force Mr Chavez out. Preparations for this continue, in parallel with the talks. And days after these began, opposition leaders signed a "unity message" with dissident military officers occupying a Caracas square since October 22nd.

Mr Chavez's negotiators (who include four cabinet ministers) condemned the opposition's "doublespeak". But their position is no less contradictory. They insist (contrary to the spirit and, arguably, the letter of Mr Chavez's 1999 constitution) that no referendum can be called before August 2003. So Mr Chavez is scheming to prevent, or at least delay, it. He refuses to sign the new electoral law required by the constitution. He questions the legitimacy of the CNE, whose board's term expired months ago to government indifference. If the CNE approves the referendum, the government says it will go to the Supreme Court to block it.

As the wrangling continues, the streets are turning violent. Disturbances on November 12th left one dead and 20 with gunshot wounds. A week earlier, another score were hurt. The government blames "uncontrollable" extremists and *agents provocateurs*. The opposition blames Mr Chavez's thugs. The abyss remains only a step away.

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A government tires

Small bribe, big stink in Chile

Nov 14th 2002 | SANTIAGO
From The Economist print edition

Much ado about campaign finance

THAT a $20,000 bribe has triggered an enormous political kerfuffle speaks well of Chile's relative lack of corruption. But it also says much about two other things: the fatigue of the Concertacion, the centre-left coalition that has governed the country since 1990, and the failure of all Chile's politicians to tackle the issue of campaign finance.

The bribe at issue was allegedly paid in 2001 to Patricio Tombolini, a deputy minister of transport, in exchange for a permit to operate a vehicle-testing plant. As well as charging Mr Tombolini, two other former officials, and three businessmen, the investigating judge has asked a higher court to strip six Concertacion legislators of immunity from prosecution. Some of them, it is claimed, also received political donations in return for favours.

The case is a huge blow to the Concertacion's self-regard—and perhaps to its unity. It still likes to think of itself as occupying the moral high ground won by having displaced General Augusto Pinochet's dictatorship. But it has been looking weary. In a congressional election last December, it only scraped to victory, its lower-house majority cut from 20 seats to six. It is increasingly prone to backbiting. Indeed, two legislators from the Christian Democrats, the largest of the coalition's four members, may have been paid to leak the bribe story to the press (they have since been expelled from the party).

The conservative opposition is quietly enjoying the Concertacion's woes. But it may not remain unscathed. Two years ago, the government of President Ricardo Lagos sent a bill to Congress that would have capped election spending and required contributions to be disclosed. The government blames the opposition, which receives far more money than the Concertacion, for blocking the bill's progress.

The scandal may have the effect of damaging public esteem for all politicians. In response, the government promises measures to cull the flocks of political appointees in the public administration—a move that it sees as a first step towards a professional civil service. And officials hope that public concern about corruption will provide the needed momentum to get the election-spending bill through Congress. That looks optimistic. It would require a display of political energy and unity that now, more than ever, looks to be beyond the Concertacion.

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China's future

Troubles ahead for the new leaders

Nov 14th 2002 | BEIJING
From The Economist print edition

AP

Despite predictions of high growth, social stability is threatened

Get article background

CHINA'S newly appointed leaders will not have a honeymoon to relax in. The line-up due to be named on November 15th at a secretive meeting of the Communist Party's Central Committee could face even greater economic and social challenges in the coming years than the country has had to tackle in the past 13 years of relative stability and rapid growth. A banking system on the verge of crisis, soaring unemployment, deflation and mounting government debt loom large among the new leaders' troubles. The familiar policy of trying to muddle through may not be an option for long.

The Central Committee itself was appointed at a week-long party congress, a five-yearly event that ended on November 14th. Apart from Hu Jintao, none of China's top seven leaders is in the new Central Committee, a sign that the party chief, Jiang Zemin, has managed to engineer at least a nominal handover of power to a younger generation of leaders led by Mr Hu. In practice, Mr Jiang, who is 76, and other retiring elders are likely to remain highly influential behind the scenes.

Not surprisingly, Mr Jiang ensured that the congress's proceedings were carefully scripted to focus on his achievements in the 13 years since he became party chief, not on the numerous problems his successors will face. On Mr Jiang's instructions, the 2,100-odd delegates to the congress agreed to revise the party charter to include his theory of the “Three Represents”, an ideological contortion that allows private entrepreneurs to join the party. Mr Jiang probably hopes that enshrining this theory in the charter alongside those of his officially revered predecessors, Deng Xiaoping and Mao Zedong, will force the new leadership to continue to respect his views on how to run the party.

But, to most ordinary Chinese, the congress and its deliberations have seemed largely irrelevant. Whatever the outcome of Friday's leadership shuffle, few expect any significant policy changes. For many members of the fast-growing urban middle class, this causes little concern. They are enjoying the benefits of GDP growth expected to reach about 8% this year and a surge of foreign direct investment that is likely to exceed $50 billion in 2002, the biggest-ever annual inflow. Exports, a key engine of growth in the wealthier coastal areas, are expected to grow by some 15% this year, notwithstanding the world's continuing economic difficulties.

The vague pronouncements issued during the congress suggest that the party indeed remains committed to a middle-class agenda: maintaining high growth (as well as social stability), encouraging private

enterprise, breaking up government monopolies and respecting private property rights. The unlucky ones—the urban unemployed and the rural population—heard comforting words about better social security, fewer restrictions on labour migration and more investment in agriculture. But, with China's fast-growing budget deficit, spending more money on the poor is unlikely to be the party's priority.

Hu Jintao's point-man for achieving these goals is likely to be Wen Jiabao, at present a deputy prime minister and almost certainly the man who will take over as the country's prime minister next March. But, if China is to avoid a full-scale banking crisis in the coming years, its leaders will require a degree of political courage which neither they, nor the outgoing elders, conspicuously possess.

Mr Jiang's report to the congress repeated the party's mantra that stability is of overriding importance. This is likely to reinforce the short-sighted view that economic restructuring which could lead to unrest is to be avoided. The government's failure to sort out the banking mess could retard growth and eventually bring a collapse of public confidence in the banking system that could have dire consequences for social stability.

Mr Hu lacks a strong power-base or a patron among the elders. As he struggles to find his feet after the congress, bold new moves to tackle state-enterprise reform and clear up bad debts (amounting to 37% of China's 2001 GDP, according to a report published in September by CLSA, a Hong Kong-based brokerage) look unlikely in the short term. The leadership will continue trying to stimulate growth through massive government spending, a policy that has led to much waste and has aggravated the dependency culture that prevails in the state-owned enterprises.

The party believes high growth (at least 7% a year) is essential if the country is to avoid an explosion of discontent among the unemployed. Without buoyant demand at home (helped by government spending if necessary), the party fears that a big downturn in China's exports or foreign investment inflows could dangerously slow growth. But pushing up debt—already well over 100% of GDP according to some estimates—could be just as dangerous in the end.

Luckily for the party, public confidence in the banking system remains high (not least because there are few more enticing investments available). And luckily, too, the rapid expansion of money-making opportunities in China in the past few years has deflected public attention away from what the party's bosses are up to. Unfortunately for Mr Jiang, however, there are many who wonder why a rare gathering such as the just-concluded party congress should focus on the cryptic rhetoric of the “Three Represents” rather than on more burning issues.

A paper published by the party last month acknowledged disapprovingly: “Some comrades think there are too many intractable problems right now and that it will make no difference whether we study [the ‘Three Represents'] or not.” Those comrades have got it right.

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Indonesia

Indestructible Golkar

Nov 14th 2002 | JAKARTA
From The Economist print edition

The party that backed Suharto remains strong

AP

Tandjung sits it out

IN MOST democracies a political party that underpinned a corrupt and repressive former regime would be wiped off the electoral map. But not in Indonesia, and not the Golkar party, the political vehicle of the country's deposed former strongman, Suharto.

Golkar's leader, Akbar Tandjung, has been found guilty of embezzling state funds intended to buy food for the poor. He is appealing against the conviction, but meanwhile remains in control of the party. Mr Tandjung is the speaker of parliament, and the party remains a prime contender in the next national elections, in 2004. It is even thought possible that Golkar might return to power, much as some overhauled communist parties in Eastern Europe staged a comeback after their ouster in the early 1990s.

The difference between Indonesia and Eastern Europe, though, is that Golkar has never really been ousted, nor overhauled. At the first election after Suharto's fall, in 1999, it came second with 26% of the vote, despite being led by B.J. Habibie, Mr Suharto's former vice-president and chosen successor. It has contributed ministers to all three post-Suharto governments.

Golkar has done little to dissociate itself from the Suharto years. It has severed its formal ties to the armed forces and the bureaucracy, but maintains informal ones, and counts many retired soldiers and bureaucrats among its members. Even supposedly reformist members of the party are reluctant to call for a purge of their more suspect colleagues. Small wonder: this month the party formed a committee to discipline members who had called on Mr Tandjung to step aside until his court case is resolved.

Even if “black Golkar”, as the unreconstructed wing of the party is known, retains the upper hand over the reformists, it may not do the party much electoral damage. Mr Tandjung argues that Indonesian voters are not so much ill-informed as pragmatic. They want a government that can build bridges and hospitals; and, whatever its past faults, Golkar is the only party with much of a track record on that score. It also has other strengths.

The electoral system is skewed against Java and in favour of the country's other islands, where Golkar's support is strongest. It still has the most effective party machinery, and, thanks to Suharto-era cronies, the deepest pockets. Its only competition for secular voters is the party of the president, Megawati Sukarnoputri, which may suffer an anti-incumbent swing in the 2004 election. Golkar even holds a certain amount of appeal for Islamists, thanks to Mr Tandjung's former position as the head of a big Islamic students' association.

But Golkar's chief advantage is that no other big party is clean enough, or zealous enough in the cause of reform, to show up Golkar's murkiness. Miss Megawati's PDI-P, which in 1999 seemed to embody the reformist cause, has since embraced several controversial figures from the Suharto era, and cosied up to the generals. The biggest Islamic party, the PPP, provided loyal opposition throughout the Suharto years, and has anyway since succumbed to an internal rift.

Golkar seems to hope that Mr Tandjung's legal troubles will play out like those of Syahril Sabirin, the governor of the central bank. His conviction earlier this year for misappropriating state funds did cause

him some temporary embarrassment. But an appeals court quashed the verdict, and Mr Sabirin is still setting interest rates. Throughout this scandal, the rupiah barely budged. The abuses of the post-Suharto era have turned Indonesia's financiers, and perhaps its voters too, into a fairly phlegmatic bunch.

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Terrorism

Confessions of a Bali suspect

Nov 14th 2002
From The Economist print edition

Police put “a bomber” on show

Reuters

Without regrets

AFTER a month of false starts, the investigation of the bombing in Bali in October is finally making headway. Indonesian police have arrested Amrozi, a Javanese man who, they claim, has confessed to buying the chemicals used to make the bomb and the van in which it was planted. On November 11th, they arrested two more suspects from Mr Amrozi's village. The investigation is also beginning to shed a little light on the network behind the attack.

The police say they used the wreckage of the van to trace Mr Amrozi back to Tenggulun in East Java, which is separated from Bali by a narrow strait. He identified the shop in the nearby town of Surabaya where he is said to have bought the chemicals, and the flat in Bali where he built the bomb. According to the police, traces of explosives found there confirm his account. He led them to an arms cache near Tenggulun and to the other suspects subsequently arrested. The police believe up to seven more men, all of them Indonesian, took part in the attack. They have identified six, two of them brothers of Mr Amrozi.

On November 13th the police produced Mr Amrozi at a press conference, and questioned him in front of reporters for more than an hour. The reporters were not allowed to ask questions, but Mr Amrozi, said to be 40 although looking younger, appeared to be very co-operative to police questioning, saying that he was happy about the bombing, and making jokes in a local dialect. His answers were spoken into a police tape recorder, which occasionally broke down.

The arrest of Mr Amrozi has served to cast further suspicion on Abu Bakar Basyir, an Islamist whom Singapore and the United States have accused of leading a regional terrorist group. Mr Basyir has denied having anything to do with the Bali bombing or any other terrorist attack. He also says he does not know Mr Amrozi. But on several occasions he is known to have visited the Islamic school in Tenggulun that Mr Amrozi frequented, and the two also seem to have spent time together in Malaysia. Mr Amrozi's confession to the police appears to dispute Mr Basyir's testimony.

The police have not revealed any evidence that implicates Osama bin Laden's al-Qaeda, despite the insistence of several Indonesian officials that it participated in the attack. Indeed, Mr Amrozi's testimony, as revealed by the police, serves to raise new questions. They say he says his intention was to kill Americans. Six Americans died, but 90 of the estimated 190 dead were Australian. This seems to raise doubt about the theory that the bombing was designed as a retaliation for Australia's participation in the war on terror.

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Afghanistan

A liberated nation, except for women

Nov 14th 2002
From The Economist print edition

Even the burqa remains

EPA

Time for caution

RAMADAN brought unexpected news to the women's ward at a Kabul prison. On November 10th, 20 women were freed, pardoned by President Hamid Karzai. Their “crimes” had been walking out on their husbands, refusing forced marriages or being named as adulterers, all of which contravene Afghanistan's strict social code. Leaving rat-infested cells, which some have shared with their children, should be a relief. But for one 19-year-old, prison may be safer than the outside world: her uncle has promised to kill her for leaving a violent marriage. And Kabul's chief of police has said he will continue to arrest women who break the code. A year after the fall of the Taliban, life for most women is hardly getting any better.

The state of medical care is another hazard. An Afghan woman will, on average, give birth to seven children. But with few clinics and staff in rural areas, and poor roads, Afghanistan is one of the worst places to be pregnant. In the remote province of Badakhshan, a man we will call Mohammed walked for five days in the snow to reach a health worker. By the time he came home, his pregnant wife had died. Surveys conducted by UNICEF and the United States' Centres for Disease Control and Prevention have revealed that Afghan women are more likely to die as a result of pregnancy or childbirth than in most other countries in the world. Yet almost nine out of ten maternal deaths could be prevented.

Women suffer too as a result of political rivalry. In northern Afghanistan around the town of Mazar-i-Sharif, clashes between Uzbek, Tajik and Hazara militias tend to end up with sexual violence against local women. There is an increasing number of reports of gang rapes and the exchange of women as payment in the settlement of feuds.

Even in less troubled areas, hopes that the end of the Taliban would bring freedom for women are being crushed by local warlords. In a report to be published next month, the American-based Human Rights Watch gives warning of increasing restrictions on women imposed in the western province of Herat by Ismael Khan, the local strongman. Pressure is being put on local women not to work for foreign NGOs. The enveloping *burqa* has once again become obligatory in some places, and a woman seen alone with a man, even the driver of her taxi, faces detention.

Most professions are closed to women, and many say that they are once again scared to go out of their homes. The central government has limited authority outside Kabul, and according to Rachel Wareham of Medica Mondiale, an NGO that works with women in conflict areas, it has in any case shown little interest in making life better for women.

Most Taliban edicts have not been repealed. The judicial commission, which is supposed to look into legal reform, is up against those clinging to tradition. The new constitution will set the tone for women's rights—the 1964 constitution granted equal rights to men and women—but Islamic law is backed by a strong lobby. Moves to re-establish girls' schools, closed by the Taliban, run into opposition. Four girls' schools were badly damaged by fire last month in the central province of Wardak. Even in Kabul, where women's lot is probably the best in the country, girls are often harassed on their way to school.

Medica Mondiale is helping women to improve their feeling of independence by learning to drive. By the end of the year, 100 or so will have learnt the theory. Getting used to the nerve-shattering traffic of Kabul will take longer. At present the NGO has only one car to practise with.

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Authoritarian Kazakhstan

Silencing the lambs

Nov 14th 2002 | ALMATY
From The Economist print edition

A tough time for government critics

Get article background

SERGEI DUVANOV is a journalist who has been a leading critic of Kazakhstan's authoritarian government. In late August, just before a trip to a conference of the Organisation for Security and Co-operation in Europe (OSCE) in Warsaw to tell the participants how things are in Kazakhstan, Mr Duvanov was beaten up and had to be treated in hospital. On October 28th he was arrested and a week later charged with raping a 14-year-old girl. He says the charge has been fabricated, and he went on hunger strike, saying this was the only way open to him to clear his name. Mr Duvanov's detention occurred before a planned visit to the United States where he was to speak to various groups on human rights in his country.

Supporters of Mr Duvanov believe that the authorities have come up with an accusation so grave that, even if it is proved to be false, there will always be a shadow hanging over him. The OSCE said in a statement last week that the pattern of events involving Mr Duvanov aroused “concerns” of political motivation.

An American government spokesman declined to comment on the rape charge but said America recognised “a pattern of harassment and abuses of journalists” in Kazakhstan. “We have regularly raised these concerns with the [Kazakhstan] government,” he said. “I am sorry to say the string of abuses has continued.” American consular officials visited Mr Duvanov in hospital after he was beaten up.

Mr Duvanov, who is 49, has long been a thorn in the side of the authorities. Among his activities he edits a weekly bulletin on human rights and the rule of law. He got into serious trouble after the publication of an article this year entitled “Silence of the Lambs”, in which he spoke of Swiss bank accounts alleged to be held by President Nursultan Nazarbaev, and he criticised parliament and government officials for fearing to speak out against the president. A separate investigation into Swiss bank accounts said to be held by Kazakh officials is currently under way in the United States. Other journalists have also been harassed, apparently on the order of the authorities. In May a business newspaper critical of government policy was fire-bombed.

Mr Duvanov is reported to have ended his hunger strike. The case is in the hands of his lawyers. If the charge of rape is upheld in court, he faces ten years in jail.

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Authoritarian Malaysia

Ten minutes of freedom

Nov 14th 2002 | KUALA LUMPUR
From The Economist print edition

A disputed security law may become even harsher

AP

No escape, says Mahathir

LAWYERS and human-rights campaigners in Malaysia often describe the Internal Security Act (ISA), which provides for indefinite detention without trial, as draconian. But according to Mahathir Mohamad, the prime minister, it is not draconian enough. When a court ordered the release of an ISA detainee last week, the government allowed him to remain free for a token ten minutes before arresting him again. And despite the fact that judges have freed only three of the 70-odd people currently held under the ISA, Dr Mahathir wants the act strengthened to prevent any recourse to the courts at all.

British colonial authorities originally introduced the act to counter a communist insurgency. Since independence, successive governments have argued that the act is necessary to prevent the race riots that used to trouble the young country. But, in practice, they have used the ISA to suppress political dissent.

In April last year, for example, the government arrested six supporters of Anwar Ibrahim, the jailed former deputy of Dr Mahathir. Four months later, they arrested ten members of Malaysia's biggest opposition party. All were accused, improbably, of plotting coups, as were the alleged Muslim militants who make up the majority of detainees. Nasharuddin Nasir, the detainee granted ten minutes of freedom, was said by the government to be a member of an extremist group.

But, since the September 11th terrorism, foreign governments, many of which have resorted to similar measures themselves, have toned down their criticism. Nor, despite Dr Mahathir's invective, have the courts interfered much. The Federal Court, Malaysia's highest, produced a spectacularly contorted ruling in September, which upheld the continued detention of Mr Anwar's supporters even as it declared their arrest illegal. Since the government can immediately re-arrest anyone set free, it has little to fear from legal challenges.

Nonetheless, it is proposing to outlaw all judicial scrutiny of jailings and arrests under the ISA. As it is, the courts can review such detentions only on procedural grounds. Many lawyers think the government's proposals are unconstitutional. But it would be a brave judge who gave a ruling to that effect. In the only other ruling to challenge the ISA this year, Hishamuddin Yunus, a high-court judge, wrote:

> It is perhaps time for parliament to consider whether the ISA, which was originally meant to counter communist terrorism in the early years of independence, is really relevant to the present-day situation. If at all it is to be retained, its provisions may need to be thoroughly reviewed to prevent or minimise the abuses highlighted in this judgment.

The judge has since been transferred. And the current review, presumably, is not what he had in mind.

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Hunger in Ethiopia

Africa's horn of famine

Nov 14th 2002 | WEST HARARGHE
From The Economist print edition

iAfrika

Facing famine, Ethiopia appeals urgently for food aid

THE famine about to strike Ethiopia could be worse than that of 1984. So says Meles Zenawi, the country's prime minister. It is a startling prediction. The calamity 18 years ago slew 1m people, and brought pictures of biblical desolation to the world's television screens. This year, the rains have failed again. Without help, 15m Ethiopians could be at risk by early next year. This is roughly twice as many as went hungry in 1984.

Yet the comparison is misleading. More people may go hungry this time round, but far fewer will die. That the government has appealed for help already sets it apart from the dreadful Marxist oligarchy that presided over the famine of 1984. The previous regime first denied the problem, then obstructed aid deliveries, because its leaders did not mind if people from rebellious parts of the country, which was then embroiled in a civil war, starved to death. The current regime is more humane. But still, it faces a tragedy.

In West Hararghe, in eastern Ethiopia, fields of sorghum have wilted, the maize crop has dried to flaky husks, and people are reduced to eating roots to survive. To the north-east, the Afar desert is even drier than usual, and the region's 1.3m nomads are losing their cattle at an alarming rate.

Ada Hussain, a pastoralist, says that 37 of his 40 cows have died in two months, and the last three are too sick to provide milk for his children. One of his neighbours, Muhammad Idris, complains that cow carcasses are poisoning the river that is their main source of drinking water.

Some of the worst-affected regions are deceptively green: the rains fell too little and too late for crops, but just enough to entice grass shoots out of the soil. A recent assessment, however, found that more than 15% of children under five in such regions are already acutely malnourished. Many will not see another harvest until August, so without aid they will surely die. The World Food Programme (WFP) says that 6m people need to be given food if they are to survive into next year.

Why is this happening? Lack of water is an obvious problem. Few Ethiopian farmers irrigate. When the rains fail, so does their harvest. Another problem is a lack of roads, which raises the cost of seeds, tools and fertiliser, and makes it harder for peasants to get their crops to market. The government is trying to tackle both problems, and so are donors. ActionAid, a British charity, hands out food to the able-bodied only if they help repair roads or dig ponds to conserve rainwater.

Politics matters, too. The old military regime used to herd peasants forcibly into collectives, with lethal results. Since its overthrow in 1991, Ethiopians have been able to grow more food, at least in non-drought years. Between 1994-95 and 2000-01, for example, production of cereals and pulses rose roughly 60%. But subsistence farmers, who, with their families, are perhaps 85% of the population, still find it hard to amass the necessary surplus in good years to see them through the bad.

Between 1998 and 2000, a senseless war with neighbouring Eritrea cost a fortune and prised many of the strongest hands off hoes and on to rifles. (In Eritrea, the aftermath has been even bleaker: 2.3m people now need food aid, out of a population of only 3m.) Ethiopian peasants are also burdened with taxes on the land they lease from the state, and levies for clinics, schools and roads. “What is [a farmer] left with?” asks Mesfin Wolde Mariam, a critic of the government, “Nothing.”

In all, there are now more than 30m Africans at risk of famine. Some are proving hard to help. Zambia has rejected American food aid because some of it is genetically modified. Swaziland's king seems determined to buy a private jet costing more than his government spends on feeding the hungry. In Zimbabwe the government is deliberately starving people it suspects of supporting the opposition.

Ethiopia has none of these problems. With American help, the government has set up a “famine early-warning system”, to identify areas where food will soon run out. An alert earlier this year attracted some aid, but not enough, perhaps because Ethiopia's troubles were overshadowed by southern Africa's. According to the WFP, Ethiopia will need at least another 2m tonnes of food aid to keep people alive next year. Commendably, America pledged 93,000 tonnes to Ethiopia and Eritrea. But it is a short-term fix. As Clare Short, Britain's aid minister, says: “If you keep giving people handouts of food, you undermine local agriculture.”

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Iran's struggle for reform

Khatami's last stand, perhaps

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If the conservatives block us, we'll quit, say the reformists

AP

Disgust at a death sentence

RECOMMENDATIONS from the late Ayatollah Ruhollah Khomeini, Islamic Iran's first “supreme leader”, were swiftly implemented. But on November 11th, when his successor, Ayatollah Ali Khamenei, urged members of the government, judiciary and parliament to put an end to their feuding, his recommendation had little effect. If the insubordination continues, Mr Khamenei may carry out his oblique threat to suppress it with violence. His predecessor would have had no qualms.

Ayatollah Khomeini was always able to carry the mass of the people with him. By contrast, the clerical establishment associated with his successor seems isolated. In the past few days, it has been threatened by an alliance composed of students, parliament and President Muhammad Khatami's reformist government.

The crisis was set off on November 6th, when a conservative judge handed a death sentence to Hashem Aghajari, a freethinking academic, for a speech he made in the summer. Mr Aghajari had attacked theocratic government, compared the imitative reverence of Shia Muslims for top ayatollahs to the mimicry practised by monkeys, and proposed a Shia version of Europe's Protestant reformation. A short spell in jail was expected, but the severity of his sentence generated fury: demonstrations, up to 2,000-strong, were held at universities across the country.

The death sentence was not the first sign of an intensified judicial campaign. Abbas Abdi, who has emerged as the reformists' most influential strategist, was arrested on November 4th, and his market-research company was closed. Many suspect that Mr Abdi's main sin was his contention that reformists in government and parliament can force conservative institutions to dilute their power by simply refusing to co-operate with them. Political motives are behind the arrest of two other market researchers: one of them made the discovery, unpalatable to chauvinistic conservatives, that most Iranians want there to be official talks with America.

The judges' real target is Mr Khatami. They are hoping to intimidate him into abandoning the two bills, now before parliament, that he sponsored. With these bills, the president is threatening the conservatives more directly than at any time since he was first elected, five years ago.

The first bill is aimed at relieving the country's conservative-dominated Council of Guardians of its self-conferred right to disbar reformist candidates from office, a right it is expected to exploit in the run-up to the 2004 parliamentary election. The second would empower Mr Khatami to act against what he sees as the conservatives' disregard for constitutional freedoms.

The complicated ratification process is expected to be completed within three weeks. If matters were to follow their usual course, the Council of Guardians, which doubles as an upper house, would then summarily veto the bills. But there is a coda. The president, his cabinet and dozens of reformist deputies have let it be known that, if the bills are blocked, they will follow Mr Abdi's advice about non-co-operation, and quit.

That could be the time for Mr Khamenei to unleash his “popular forces”. These are the paramilitaries and

bully-boys who were instrumental in putting down riots in 1999. So far, there has been no confrontation. Taking their line from the supreme leader, who has tried to put about his impartiality by implicitly criticising Mr Aghajari's sentence, the paramilitaries made no serious attempt to break up the peaceful student protests.

In the past, heated rows between conservatives and reformists have usually ended in compromise. The conservatives are jittery about non-co-operation. If Mr Khatami and his government were to quit, the regime would be bereft of the shreds of popular legitimacy that the president's presence confers on it. Mr Khatami is useful for another reason, too. His popularity abroad is all that protects Iran from bellicose suggestions, including those emanating from Israel, that the Islamic republic is eligible for regime change.

Mr Aghajari's sentence, and the latest arrests, could be bargaining tactics. The conservatives may intend to dangle leniency—by commuting Mr Aghajari's sentence, for instance—as a way of persuading Mr Khatami to drop his threat to resign. But the president will find it hard, this time, to back down: he has made a bold stand, and his place in history is at stake.

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Crackdown in Jordan

Black masks amid the devout

Nov 14th 2002 | MAAN
From The Economist print edition

Pro-Iraqi dissent is growing among Jordan's loyal, indigenous tribes

Get article background

AN ARAB city where tanks roll through the streets, helicopter gunships fire at homes, soldiers wage house-to-house combat, and the police impose a curfew? It sounds like Nablus, said Jordanians, thinking of Israel's latest assault. But the town is Maan, 200km (125 miles) south of Amman, and the force that stormed it is Jordanian. Four days after the assault was launched on November 10th, the town's mosques, normally full for Ramadan prayers, were empty, residents needed written permits to leave their houses, and a pervasive sense of danger hung in the air.

Officially, the assault was to arrest a local preacher, Muhammad Shalabi. For two weeks, officials have been seeking to interrogate the cleric about last month's killing of Lawrence Foley, an American diplomat. But Mr Shalabi appears to have escaped. Bewildered Maanis wonder why the intelligence services did not do what they usually do: mount a discreet operation to grab the man. The show of armour seems a sledgehammer to swat a fly.

But Mr Shalabi was no simple firebrand, reply officials. They paint a picture of a band of brigands holding hostage the frightened and beleaguered people of Maan. Maanis themselves say he belonged to a group called Takfir wal Hijra, which had declared the king (and others) to be unbelievers. His disciples, they say, used to prowl the streets in black masks, and prayed, with grenades strapped to their chests, for an Islamist protectorate.

Traditionally, Jordan's Islamists are well integrated into the political structure. But this is changing. King Abdullah is determined to mount his own war on terror, before American troops offer to do the job for him. No less important, he wants to nip in the bud any armed resistance to an American strike on Iraq. Jordanian preachers have already begun unleashing *fatwas* ordering a *jihad* in the event of war.

Maan, a city that has rebelled against authority four times in the past 13 years, was an obvious choice. Located on the desert edge, the town can trace a history of revolt back 2,000 years. More recently, demonstrations in support of Iraq have repeatedly spiralled into rioting (the pro-Iraq Baath Party has old roots in the town).

Now the town is sealed off from the rest of the kingdom: checkpoints block the highways, and telephone lines are cut. The king, making a hastily arranged trip to Mecca, has apparently sounded out the Saudi leaders on barring Mr Shalabi's way south. The government says the operation will continue until all unlicensed guns in the south have been confiscated: a huge target since most tribesmen are armed.

But, so far, the unrest has shown little sign of spreading to other towns. Significantly, Jordan's Palestinian majority, concentrated in the Amman region, has shown less agitation about Jordan's possible role in a war on Iraq than have the indigenous tribes to the south.

Yet Maan is particularly important to the monarchy. When the king's great-grandfather, Abdullah I, first rode up from the Arabian peninsula to claim the east bank of the Jordan in 1920, Maan was the first town to herald him king. Ever since, the Hashemite monarchy has relied on a bedrock of indigenous support. But Maan eyewitnesses tell of masked men manning machineguns on roof-tops to resist the army sent from the north. And the hospital has orders not to release the bodies of the few people killed lest funerals degenerate into *intifada*-like protests.

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Kenyan prisons

Inmates want more porridge

Nov 14th 2002 | NAIROBI
From The Economist print edition

Because the guards are eating their food, and they are starving

JON NJUGUNA, a thief nearing the end of an 11-year sentence, slipped out of a Kenyan prison late last month, grabbed a parcel of cunningly-stashed clothes, and hot-footed it straight to the commissioner of prisons in Nairobi.

He wanted to complain that his fellow-inmates were starving. The reason: warders were stealing their food. Kenyan jails are dire, with 50,000 inmates crammed into cells built for 15,000, and an estimated 90 deaths each month from disease, neglect and torture.

En route, Mr Njuguna stopped by at the offices of Kenya's leading newspaper, to make sure that the authorities did not have the option of hushing the matter up. So they tried to discredit him by disputing the less important parts of his story. He was only in jail for seven years, they said, not 11. To his allegations of starvation and buggery, no response.

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Israel's Labour Party

Fantasy-land prime ministers

Nov 14th 2002 | JERUSALEM
From The Economist print edition

Labour's choice is whether to oppose, or be junior partners again

IN A television debate on November 12th, the three candidates who next Tuesday will compete to be leader of the Labour Party said what they would do if they were Israel's prime minister. Good ideas, some of them, but all political pie-in-the-sky, given the strength of the lead that opinion polls give the rival Likud.

“If I were prime minister,” fantasised Amran Mitzna, Haifa's mayor and the current front-runner, “I promise to separate Israel from the Palestinians, by negotiation if possible, if not, then by unilateral withdrawal.” Haim Ramon, a veteran Labour politician, said he would not waste time trying to negotiate with the present Palestinian leaders, but would press ahead with the “security fence” between Israel and the West Bank. Binyamin Ben-Eliezer, the incumbent Labour leader, said that once he was prime minister, new Palestinian leaders would come forward to negotiate with him over the Clinton proposals and the Saudi Arabian peace plan.

But the reality is that Ariel Sharon seems firmly on course for victory, both over his Likud challenger, Binyamin Netanyahu, in their party primary on November 28th, and in the general election two months later. A midweek survey on Channel Two television gave the Likud 36 seats to Labour's 18 in the 120-seat Knesset.

The prospect of defeat did not staunch the three putative prime ministers' internecine vitriol. Mr Ben-Eliezer poured scorn on Mr Mitzna as a naïf and a political neophyte. Mr Ramon disparaged Mr Ben-Eliezer, until recently minister of defence, for having served “as sous-chef in Ariel Sharon's kitchen cabinet” which dished up two years of disaster to the Israeli people. Mr Mitzna, a bearded and dour ex-general, said he offered a new and different leadership for the dispirited old party.

Will that be as leader of the opposition, or will Labour sidle back into Mr Sharon's embrace after the election? Some Labour members positively yearn for the rehabilitative effects of a spell of uncompromising, and uncompromised, opposition. They say that another term as the Likud's junior partner would mean ideological and psephological demise. Yossi Beilin and other prominent doves say they will leave if that happens, and join the Meretz Party in a new social-democratic alliance.

But Mr Ben-Eliezer made it clear in the debate that if he is still leader he will want to lead Labour right back into a coalition with Mr Sharon after the election. And Mr Sharon, addressing his party's convention a few hours earlier, said much the same. He knows that even a much-enlarged Likud could still have trouble sustaining a stable government without Labour, even a much-shrunken Labour.

Mr Ben-Eliezer admits that the outgoing government “did nothing” of merit. He argues, though, that Labour's presence at the cabinet table had curbed the Likud. “I've been gone three days,” he said, “and they're deporting Arafat already.”

In fact, though, Mr Sharon made no move to deport the Palestinian leader from the West Bank, ignoring Mr Netanyahu's urging that he do so in the wake of the murder on November 10th of five civilians, including a mother and her two children, in a kibbutz in Israel. The terrorist was a Fatah-Tanzim militant, nominally therefore a Yasser Arafat supporter (Mr Arafat ordered an investigation). But Mr Netanyahu's deportation proposal was “irrelevant”, an aide to Mr Sharon explained. It would also, certainly, have upset the Americans.

Instead, the prime minister and his new minister of defence, Shaul Mofaz, unleashed on November 13th yet another armoured incursion, this time into Nablus, a city that Israel says is the source of much of the

current terrorism. The troops will stay there for weeks, searching house-to-house for weapons, explosives and wanted men. And tens of thousands of people will spend the time cooped up under curfew.

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German politics

Gerhard Schröder's rocky new start

Nov 14th 2002 | BERLIN
From The Economist print edition

Back to office he came in September, and so far what a mess he's making of it

Get article background

NEVER in modern German history has a newly elected government got off to such a wretched start. With Germany now teetering on the brink of its second recession in just over a year, there is an increasing sense of helpless floundering at the top. Forget the “steady hand” on the tiller that Gerhard Schröder promised when the economic going first began to get rough last year. This is now rudderless drift. And with a mutinous crew to boot. Small wonder many of the passengers are already wondering whether they chose the right captain on September 22nd.

Right up to the general election, Mr Schröder's then government had assured voters that it had everything under control. Times were certainly difficult, it said, but it was still expecting modest growth of 0.75% this year, rising to 2.5% next year. Tax increases? No question of that: to do it during an economic downturn would be “economically absurd”, Mr Schröder insisted. Welfare contributions? They would be “stabilised”. And the public deficit? Hans Eichel, the finance minister, was “certain” that Germany would keep within the European Union's 3% limit. All that has now been turned on its head.

The government no longer expects the economy to grow by more than 0.5% this year and 1.5% next. And even that looks optimistic. Germany's “five wise men”, the government's independent economic advisers, now forecast growth of just 0.2% this year and 1.0% next. The ZEW institute's monthly index of business expectations plunged this month to its lowest level since just after the terrorist attacks on New York's twin towers, suggesting, according to the institute's president, Wolfgang Franz, a “nosedive” of economic activity in Germany in the first half of next year. Europe's biggest economy is in crisis.

Slowing growth and rising unemployment have already led to a collapse of tax revenues and a jump in welfare spending, creating yawning gaps in budgets at both federal and local level, as well as in public-health and pension funds. The government is seeking to plug the holes with a mix of tax rises, spending cuts, increased welfare contributions and new borrowing. But the public deficit is now certain this year to overshoot the 3% limit by a long chalk—the government estimates 3.7%—and perhaps next year too. Germany will become the second country after Portugal to get an official reprimand from the EU.

Many Germans feel cheated and betrayed. Support for Mr Schröder's Social Democrats has plummeted. Less than two months after scraping back into power, they now trail the opposition Christian Democrats by 14 percentage points. Opposition leaders accuse the government of carrying out “the biggest electoral fraud in German history”. Two Germans in three do not believe that the government's cobbled-together austerity package will bring the promised boost to growth and jobs. Indeed many, including most economists and business leaders, expect it to have just the opposite effect. Tens of thousands of workers took to the Berlin streets this week to vent their anger, frustration and fears.

At one point this week it looked as if the government might be faced with a humiliating defeat in the Bundestag, parliament's lower house, after a group of Greens, the Social Democrats' junior coalition partners, threatened to vote against a proposed rise in pension contributions from 19.1% to 19.5%. This, combined with expected increases in health contributions, risks pushing Germany's non-wage labour costs, already among the highest in the world, well over 42% of gross wages. The rebels agreed to back the measure only after the government promised to ask a new commission on health and pension reform

to extend its recommendations to ways of bringing down non-wage labour costs. Relations remain tense—and the government has a mere nine-seat majority.

The commission on health and pension reform, which has just been given its brief, is Mr Schröder's answer to complaints about his new government's apparent lack of commitment to radical structural reform. Modelled on the earlier Hartz commission on labour-market reform, the new body, due to report in a year, is to be chaired by Bert Rürup, one of the five wise men. The government is already rushing through emergency measures to shore up the health system's finances, including a freeze on hospital budgets and doctors' fees and cuts in medicine prices. But there are already doubts whether Mr Schröder will have the guts to face up to the powerful lobbies in the medical profession and push through long-term reforms.

He has already begun to water down the Hartz commission's labour-market proposals, his government's supposed flagship reform, in response to pressure from the unions. His ability to implement unpopular reforms will anyway be limited by the opposition conservatives' control of the Bundesrat, the upper house of the legislature, where Germany's 16 states are represented. Meanwhile Verdi, the powerful union representing the 4.5m workers in the public sector, is threatening to strike over a claim for a wage rise “significantly over 3%”, which neither the cash-strapped government nor the debt-ridden local authorities can afford.

Mr Schröder knew he would be facing a difficult second term in office. But he never imagined that it would start off this tough. And he has no room left for manoeuvre.

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Der Spiegel and Germany's press

His country's mirror

Nov 14th 2002
From The Economist print edition

Germany's Der Spiegel blazed a trail. Now the country has caught up

Reuters

Half a century of august scrutiny

POST-WAR Germany would have been a much duller and less democratic place without Rudolf Augstein, the founder-publisher of *Der Spiegel* (The Mirror), who died last week aged 79. The magazine—a thumping great glossy thing which takes a week to read properly—often beat the rest of the German press combined. In a country where journalism, particularly in the past, tended towards the pompous and docile, it had the most lucid prose, the best investigative reporting, the widest foreign coverage, the sharpest political analysis, and the most insightful social commentary. Its legendary archive, people said, only half-jokingly, was bigger than that of Germany's security service, and a darn sight more reliable.

Mr Augstein is the last in a line of post-war media grandees to leave the stage. Others included Gerd Bucerius and Countess Marion Dönhoff of the more high-brow *Die Zeit* (The Time), and Axel Springer, who owned the country's first national broadsheet daily, the fiercely anti-communist *Die Welt* (The World), as well as the saucy *Bild* (Picture), Europe's biggest-selling tabloid.

In their different ways, they leave Germany much better than they found it when they started in journalism after the war, in a ruined, defeated, foreign-occupied and divided country. The cold war is won, domestic terrorism vanquished, the country reunified. Nobody worries about German democracy now.

Mr Augstein's success in making *Der Spiegel* one of continental Europe's most influential magazines annoyed people. He was bad-tempered and self-indulgent. Some of his scoops were dodgy, and his relentless anti-clericalism infuriated the church. He was a touch harsher on the political right than the left, and dealt brusquely with traditional rural and conservative values, deep-rooted in places like Bavaria but not in his native northern Germany. Some thought him too soft on communist East Germany, though he eagerly supported unification after the fall of the Berlin wall.

But he was usually right on the big things. His three-month imprisonment and release over a military secrets scandal in 1962 entrenched press freedom over the objections of West Germany's cold-war securocrats. He knew that relentless scrutiny of the rich and powerful was the way to make the country work better. It did.

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The European Union's convention

Let's start harmonising taxes

Nov 14th 2002 | BRUSSELS
From The Economist print edition

A constitutional convention is touting some reforms that appal the British

BRITAIN and Ireland could soon face an unpalatable choice: give up their veto over tax issues or leave the European Union. This stark prospect has emerged from the latest deliberations of the convention charged with drawing up a new constitution for the EU.

Klaus Hansch, a German Social Democrat who led a sharply divided working group on economic issues, suggested to delegates to the convention that one idea that did command majority support is to set minimum EU-wide corporate tax levels "to let the internal market function effectively and to stop unfair tax competition". These rates would be decided by the majority vote of EU countries—an idea that is anathema on principle to the British and menaces the Irish, who have a much lower corporation-tax rate than the EU's average.

A move to majority voting on some tax issues was backed by the French and German governments and has also found favour with Valéry Giscard d'Estaing, the convention's chairman, who will have a big influence on its final proposals. He even argues that countries refusing to ratify the new constitution may have to leave the Union, since the new constitution will replace its existing treaties; countries that fail to accept it will in effect be choosing to opt out of a revamped EU.

Any new constitution emanating from Mr Giscard d'Estaing's convention will still have to be negotiated by all EU countries in an "intergovernmental conference" before countries are called upon to ratify it (and in a number of countries ratification may involve referendums). The British and Irish are adamant that they will block any move to scrap the veto over tax.

Mr Giscard d'Estaing's people, however, hope that the convention's deliberations will give the constitution enough legitimacy and coherence to withstand revision. "We will present a complete construction," says an official close to Mr Giscard d'Estaing. "If one country removes one brick, then another will remove another, and the whole thing will collapse." The official also points out that not only Britain and Ireland will be put on the spot. "The Germans do not want to give up the veto over immigration and asylum. Everybody will have tough decisions to make."

In an effort to ease these "tough decisions", officials around Mr Giscard d'Estaing are considering a new form of "super majority voting" for particularly sensitive issues like tax or foreign policy. This would prevent a single country from blocking EU decisions. It would, for example, stop a Baltic country from vetoing a policy initiative towards Russia, but might let a big country like France, Britain or Germany block an EU initiative with the support of just one or two other small countries.

Even this proposal, however, is unlikely to assuage the British and the Irish, who see national control of tax policy as an uncrossable line. This pair expect little support within today's 15-strong EU, but have some support from among the ten mainly Central European countries that are meant to join the Union in 2004. Danuta Hubner, the Polish government's representative at the convention, says her country regards the ability to set its own taxes as a necessary tool in its bid to close the economic gap with western Europe.

But there is a snag. The intergovernmental conference to consider Mr Giscard d'Estaing's constitution is

supposed to wind up in 2003—before the new members join the Union. They will be allowed to observe intergovernmental haggling over the constitution. They may even be allowed to speak. But they will have no right to shape its provisions. Naturally, however, they will still be expected to ratify the end-product.

A British diplomat harrumphs that agreeing to a new EU constitution just a couple of months before the Poles and others join the club would be “treacherous behaviour towards the new members”. The French, Germans and Italians do not appear to agree. Funny, that.

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Central Europe's presidents

The mantle passes from Vaclav to Alexander

Nov 14th 2002 | WARSAW
From The Economist print edition

Alexander Kwasniewski will replace Vaclav Havel as the region's doyen

WHEN George Bush presses the flesh of Central Europe's leaders at the NATO summit in Prague on November 21st and 22nd, Poland's president, Alexander Kwasniewski, may be making many of the introductions. He will take over the mantle of Central Europe's most recognisable president once the Czechs' ailing head of state, Vaclav Havel, retires in January.

Mr Havel's admirable dissident past and literary distinction gave him special status in western capitals. Mr Kwasniewski, once an ambitious young minister under communism, has no such authority. But his political skills, honed in the post-communist era, have burnished his reputation. Poland has been a middleman in helping NATO to expand. Its president has proved versatile, charming Mr Bush one day and tough former apparatchiks like Ukraine's boss, Leonid Kuchma, the next.

The Polish president and his American counterpart toured the American mid-west together for several days in the summer. Mr Kwasniewski got red-carpet treatment partly because Poland is a trusty American ally in a shaky region and partly because there are some 10m Americans of Polish descent, many of them working-class Reagan Democrats clustered in rust-belt states that have been recent battlegrounds for the two main American parties. Bill Clinton reclaimed the Poles during his presidency. Mr Bush wants them back.

The trip was also important for Mr Kwasniewski. He touted for investment, pressed for a broad NATO enlargement to include two of his country's neighbours, Slovakia and Lithuania, and stressed the importance of America to Poland. “Our foreign policy is built on two pillars,” says Mr Kwasniewski: “Europe, and America's engagement in Europe.” Attempts to remove one of those pillars would spell disaster, he reckons. Hence Poland's anxiety about the current *froideur* between Washington and Berlin. Poles yearn for friendship with America but depend on Germany, their most important neighbour and trading partner, to stay a sturdy part of a transatlantic axis.

The American trip was a chance for Mr Kwasniewski, who turned 49 this week, to sell himself, too. He must leave office in 2005 after two terms. He strongly hints that he may then start a new centrist party which, he says, might win 15-25% of the votes and hold the balance between right and left. Or he may seek a new career farther afield, perhaps as head of NATO or even of football's world body, FIFA.

That all depends on Poland getting into the European Union in 2004. Both Mr Kwasniewski and Poland's leftish prime minister, Leszek Miller, have staked their future on a yes vote in an EU referendum, perhaps next June. Anything less than a vote that goes two-to-one in favour, says Mr Kwasniewski, would be a failure—though that is setting the bar high. The yes camp has been boosted by a slight upturn in the economy and by an endorsement from Pope John Paul.

But the no campaign will be noisy and emotional. Many Poles, not least those on the farms, think that the EU in Brussels has given them a rotten deal. If Mr Kwasniewski were to persuade two-thirds of all Poles to vote yes, that would be one of his biggest feats to date.

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Italy's globalisation debate

Fallacious Fallaci

Nov 14th 2002 | FLORENCE
From The Economist print edition

Why fears of riots in an Italian city were mercifully unrealised

AP

This time they got on better

THE European Social Forum, a gathering—broadly speaking—of anti-capitalist sceptics about globalisation and American foreign policy, last week drew more than 500,000 people to Florence, one of Italy's most fragile cities. Italians were worried. In the summer of 2001, when the G8 rich countries' leaders held a summit in Genoa, anti-globalist extremists ransacked the place and attacked the police who then lost their heads. A young man was killed, many people were beaten up. This time nothing happened. Peace prevailed. The no-global marchers proved gentler than the phalanx of tourists that plough through Florence every weekend.

Why? First, border controls were tightened and hundreds of would-be troublemakers were turned back. Second, the police did not create no-go areas, as they did in 2001, but deployed lots of police, many in plain clothes, using quiet mobile phones instead of crackly radios. Third, the forum organisers tightened their own security; rallies of the different groups were harder for strangers to infiltrate.

But there may have been another, quirkier, reason for the calm. Oriana Fallaci, Italy's most famous female writer, followed up a ferocious and controversial spring-time attack on Islam with a no less vitriolic full-page piece in *Corriere della Sera*, a leading daily, vilifying the no-global movement, and saying that it menaced Florence, her home town (though she now lives in New York), as viciously as the occupying Nazis had done. She invited Florentines to close down their city and hang signs saying “Closed for Mourning”.

She insulted just about everyone, from Florence's mayor to leaders of Italy's left, from Italy's right-wing prime minister, Silvio Berlusconi, to its centrist president, Carlo Azeglio Ciampi, whom she upbraided for not returning her call. Florence's mayor said her piece was “petrol on a fire”.

In fact, it was more like oil on a stormy sea. Mrs Fallaci's article was so widely discussed that the demonstrators seemed determined to prove her wrong. In the event, they were unusually polite. Florentines responded in kind, offering drinks and cakes to strangers out of windows. Passions ran high only when Italian marchers began arguing over who actually headed Italy's no-globalists. Some, even more provocatively, dared ask: what exactly did they want?

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Cyprus

Hold your breath: this time a breakthrough is truly possible

Nov 14th 2002 | NICOSIA
From The Economist print edition

Rarely have there been higher hopes for a settlement in Cyprus

Get article background

HOPE is a word not usually associated with talks about reunifying Cyprus. Since the Greek- and Turkish-Cypriot communities split up so violently when the Turkish army invaded the northern part of the island in 1974 to prevent *enosis* (union) with Greece after a coup plotted in Athens, dozens of UN envoys and western diplomats have tried—and failed miserably—to nail down a peace settlement acceptable to both Greeks and Turks. Until now, that is. This time, hope of a breakthrough is higher than ever.

On November 11th, Kofi Annan, the UN's secretary-general, put forward a 136-page document with detailed proposals for reuniting Cyprus in a Swiss-style confederation of two “component states” loosely joined together as a “common state” under a presidency that would rotate every ten months. Politicians in Turkey, Greece and both parts of Cyprus have given it a cautious welcome.

Now the UN is squeezing both Glafcos Clerides and Rauf Denktash, the aged Greek- and Turkish-Cypriot leaders, to sign at least a framework agreement before December 12th, when European Union leaders are expected to approve the entry of ten new countries, including Cyprus, into the EU club. Mr Annan wants a definite go-ahead from both the top Cypriots as early as November 18th in order to start negotiations immediately. All being well, details would be hammered out by February; both lots of Cypriots would hold separate referendums to approve the settlement in March; and the EU would admit a reunited Cyprus, not just the Greek-Cypriot south, at the beginning of 2004.

This timetable may be too ambitious. Mr Clerides thinks it will take his lawyers more than a week to trawl through the plan; Mr Denktash is in New York, recovering from a heart operation and unable to work more than a few hours a day. In the coffee-shop tradition of Cypriot politics, building a consensus, even if the climate is more or less favourable, always requires more meetings and argument galore.

The Greek Cypriots, who made up four-fifths of the island's population in 1974, have made concessions over the constitution for the sake of getting back a good chunk of territory. The Turks' share of the island would go down from its present 36% to 28.5%; the Greeks would get back part of the citrus-growing district of Morphou, the coastal town of Varosha and its derelict high-rise beach hotels built in the early 1970s, and part of the unspoiled Karpas peninsula, much coveted by Greek-Cypriot tourist developers. About 85,000 out of some 200,000 Greek Cypriots forced from their homes in the north in 1974 would be able to return to areas that would again come under a Greek-Cypriot administration, probably a big enough number for Mr Clerides to win backing in a referendum.

The UN's legal draftsmen have been creative. They seem to have got round old sticking points such as Mr Denktash's demand that his northern fief be recognised as a sovereign state and the Greek Cypriots' insistence on a federation rather than a looser confederation. Even after a settlement, according to the UN plan, the two communities would still live apart and run their own affairs in their component states, with separate police and courts.

Moreover, Cyprus would be demilitarised and banned from buying weapons. The UN peacekeeping force which was sent to the island in 1963 after an early bout of intercommunal violence and which, since

1974, has overseen a buffer zone known as “the green line” that separates Greek and Turkish Cypriots, would stay on indefinitely. But it would be bolstered by Greek and Turkish soldiers. Three of the nine judges on the common state's supreme court would be foreign.

But new sticking points may well pop up. Some Turkish Cypriots will be loth to hand back property they have occupied for almost a generation. Greek Cypriots dislike the idea of any Turkish forces remaining on the island and particularly resent the presence, which may apparently continue, of some 100,000 mainland Turks who have settled since 1974, as indigenous Turkish Cypriots emigrated in droves from Mr Denktash's self-declared republic, mainly to Istanbul, Turkey's commercial capital, and to London.

Would the new common state be viable? It would have many trappings of nationhood, with a two-chamber parliament, an independent central bank, a ministry to handle foreign affairs and a separate one to deal with the EU (each with a minister from a different community). Both Cypriot leaders will be urged by the leaders of their parent states to accept the deal. The Americans are also pressing Greece and Turkey to seize what looks like an unprecedented chance. Turkey's government-in-waiting appears eager to make a fresh effort over Cyprus. There has even been talk in Ankara of letting another negotiator replace Mr Denktash if his convalescence is slow. In Athens, Costas Simitis, the moderate Socialist prime minister, wants to speed up a rapprochement with Turkey during Greece's six-month EU presidency which starts in January.

If they accept the UN plan, Messrs Denktash and Clerides would have an option to stay on as the common state's co-presidents for three years. They might be candidates for a joint Nobel peace prize. Enough to persuade them to cut a deal?

In the past, the answer has plainly been no. But the change of guard in Ankara, Mr Denktash's illness, renewed goodwill and tighter-than-ever deadlines all suggest that there is at least a fair possibility.

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Charlemagne

Too big for Europe?

Nov 14th 2002
From The Economist print edition

The Turks are at the gates of Brussels

Get article background

THEY sing in the Eurovision Song contest, play football in the European football championships and deliberate in the Council of Europe. But apparently it is all a misunderstanding. Turkey is not a European country. That is the opinion of none other than Valéry Giscard d'Estaing, chairman of the convention on the European Union's future. Turkish representatives are at the convention and the EU has told their country it is a candidate to join the club. But according to Mr Giscard d'Estaing it would be “the end” of the EU if Turkey were ever actually to get in.

The intervention of VGE, as he is familiarly known in France, was widely attacked. A war with Iraq is on the horizon, there are warnings of an imminent al-Qaeda attack in Europe, the EU badly needs Turkish co-operation to secure a settlement in Cyprus and Turkey has just elected a government with Islamist roots. What a time, groaned the critics, to insult the most secular and pro-western Muslim country there is. Mr Giscard d'Estaing's critics seized on his “gaffe” to argue that the man is clearly past it.

In fact, VGE's intervention was carefully timed. For the European Union is fast approaching a real moment of decision over Turkey. At the EU summit in Copenhagen next month, the club's current 15 countries are expected to sign agreements to let in another ten, mostly from Central Europe. They will also face mounting pressure to offer Turkey, too, a date for the start of negotiations to join. A European official in Brussels argues that while eventual Turkish membership is not inevitable as things stand, once the negotiating process begins it will be all but unstoppable. So VGE's intervention was a last-minute appeal to European leaders to call a halt, before they head down a path from which there may be no turning back.

Some interpreted Mr Giscard d'Estaing's rejection of Turkey as an assertion that the European Union is “a Christian club”. VGE is considering inserting an assertion of Christian values into his draft constitution and recently conferred with the pope. But Turkey's Islamic culture is only a part of the argument made by those who are sceptical of its candidacy. Another point made by the convention's president is that 95% of Turkey's land mass is actually in Asia. Once geographic criteria for membership are blurred, how will the EU ever define its boundaries?

But the biggest single anxiety is over Turkey's size. On current demographic trends, by 2020 Turkey (now 67m-strong) may have more people than Germany (now 82m-strong but shrinking). That would make Turkey the largest country in a union which is already a lot more than a mere free-trade area, though it is yet to evolve into the Eurosceptics' dreaded super-state. In the Netherlands, for example, around 40% of new national laws are simply implementations of decisions made by the EU. EU laws themselves are increasingly made by majority vote; if Turkey got into the EU it would have the largest number of votes in its legislative bodies—the Council of Ministers and the European Parliament. It would also, in time, adopt Europe's single currency and its people would be free to move to Western Europe as they pleased. Anti-immigration parties, with a strong anti-Muslim tinge, have recently gained ground in France, the Netherlands and Austria. “Letting Turkey into the EU”, says a prominent European politician, “would mean more Le Pens and Haiders.”

All overblown, say Turkophiles. Big though it is, Turkey would still make up less than 15% of an EU that would then embrace around 600m people. Worries about its democratic credentials would, they argue, be addressed by the very process of negotiating entry. Before any country can even start talking to the EU, it has to conform to certain democratic norms. This year the Turks have abolished the death penalty and started easing language restrictions on their Kurdish minority. Recep Tayyip Erdogan, whose Justice and

Development Party has just won the Turkish election, recently told EU ambassadors that his party would now move to abolish the use of torture—the largest remaining human-rights obstacle to the beginning of negotiations. Once they do begin, the lucky Turks would have to adopt around 80,000 pages of EU law, covering everything from employment rights to clean-air rules. It will all take a long time—certainly more than a decade—and the Turkey that emerged at the other end would be a very different place. Rather than fearing Turkey's impact on the EU, says Heather Grabbe, of the Centre for European Reform, the Europeans should rejoice in their power to mould and stabilise a large and strategically crucial neighbour.

A habit of being trapped by breezy promises

Whether such a policy would necessarily mean offering Turkey full membership of the EU will doubtless preoccupy many a future seminar. In the real world, however, there is a feeling, *pace* Mr Giscard d'Estaing, that things are moving the Turks' way. The Americans, who have always promoted Turkish membership of the EU for their own strategic reasons, are pressing the Europeans to be amenable.

This may be working, particularly on the Germans, who are desperate to get back into American good books after being told that Gerhard Schröder's electioneering hostility to American policy over Iraq had “poisoned” relations. In Turkey, meanwhile, Mr Erdogan is playing his hand intelligently. He reacted in a measured way to Mr Giscard d'Estaing's remarks and hopes that Turkey will raise its standing in EU circles by putting its weight behind a Cyprus settlement.

Whatever happens at the Copenhagen summit, the EU has an ingrained characteristic working in Turkey's favour: a habit of being trapped by its own promises. Privately, many EU leaders are still queasy about letting in the Central Europeans, let alone the Turks. But they promised to let in the ex-communists over a decade ago: what they said publicly turned out to be more important than what they thought privately. It is a logic that worked for Central Europe. It may yet work for Turkey.

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Higher education

The ruin of Britain's universities

Nov 14th 2002
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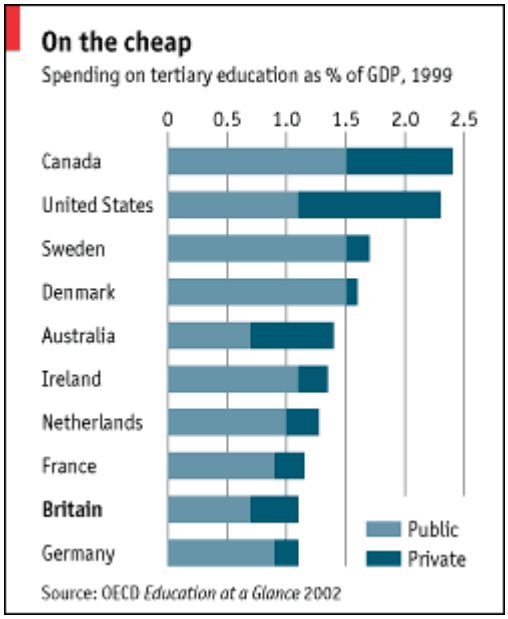
British universities have too little money to do their job properly

Get article background

THE procrastination would impress the idlest of students. During last year's general election campaign, the government discovered that changes it had made to the way universities and their students are financed had peeved many voters. So in October 2001 it announced a review of the system. Because whether and how students pay for tuition is inextricable from how universities themselves are funded and organised, the review came to encompass a general, ten-year strategy for higher education as a whole. After repeated delays, its outcome was due this month. Then Estelle Morris, the education secretary, resigned, and the announcement was delayed again.

In mitigation, this extended essay crisis has been provoked by a particularly tough assignment. The malaise that afflicts Britain's universities has been brought about by decades of haphazard, myopic and self-interested policymaking, and the mishandling by successive governments of the transition from an elite to a mass system of higher education.

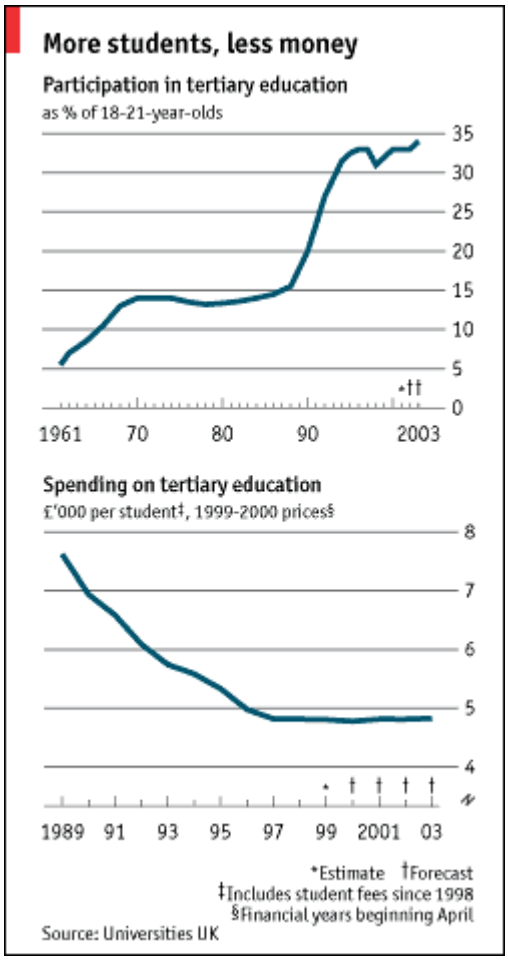


As in many other western countries, the number of students entering higher education in Britain has grown enormously in the past 40 years. Whereas around one in 20 school-leavers went on to university in 1960, more than one in three do so now. There was an especially big boom in the number of young people going on to higher education in the late 1980s and early 1990s, which has since levelled off: Tony Blair wants to revive it, and has set a target for 50% of 18-to-30-year-olds to experience higher education by 2010.

Many countries have struggled to manage such educational explosions, but in Britain it has been handled especially badly. Kingsley Amis, a novelist and academic, famously grumped in 1960 that “More will mean worse.” To an extent, that was inevitable: different standards of entry and teaching are bound to obtain when, as is now the case, higher education is provided in around 170 universities and higher education colleges, plus a variety of other facilities, rather than in a handful of elite institutions. But British governments have helped prove Mr Amis right by refusing to ask people to pay, either directly, through fees, or indirectly, through taxes, for all the extra students.

Expenditure per student has declined steadily, with a more rapid fall during the early 1990s (see chart). Since 1989, funding per student has fallen by 37% in real terms, while student numbers have increased by 90%. The income per student at Harvard and Yale is now, respectively, 4.5 and 3.2 times as much as Oxford's.

This squeeze has had predictable results. The ratio of students to teachers has doubled from around 9-1 ten years ago to 18-1 now. Dons' pay has declined not only in relation to the private sector, but also to other public-sector jobs: a new lecturer at one of Britain's old universities now earns about the same as a new policeman. Some universities are looking to poorer countries—South Korea, China, Eastern Europe—to fill junior posts.



Buildings, facilities and equipment have deteriorated. The higher education sector as a whole is in the red. Despite the dollop of cash for science that last year's government spending review provided, Universities UK (UUK), which represents higher education heads, reckons that in addition to the around £8 billion ($13 billion) of public money it receives annually, the sector needs an extra £9.94 billion over the next three years to put things right—a fantasy, says the government.

Money is not the only problem. Within the broad economy of higher education, many different types of students study an enormous variety of subjects in a wide range of institutions. Unfortunately, the tendency of policy has been to erase or deny the differences between them.

This tendency was most starkly manifest in the decision by the last Conservative government, in 1992, to scrap the distinction between universities and what were previously known as polytechnics. Martin Trow, of the University of California, Berkeley, a long-term-student of British and American higher education, says that this was a move “exactly in the wrong direction”: whereas what was needed was a clear articulation of the different characteristics and callings of different institutions, the reform obliged many of them to compete for the same resources and be judged (in some cases unfairly) by the same criteria.

No Nobels

It is difficult conclusively to prove the notion that Britain's top universities are falling behind their international counterparts, such as Harvard and Yale. There is, after all, no internationally agreed definition of what a university is supposed to do. “Fitness for the world”—what J.H. Newman, the great 19th-century advocate of a liberal education, saw as its ultimate aim—is tricky to measure. Teaching is obviously part of any definition; but it is difficult to compare the modular education offered in top American colleges with Britain's single-subject approach.

The creation of wealth, directly as well as indirectly, is increasingly regarded as part of a university's role; and in terms of the efficiency with which they spin off companies and pull in outside investment, British universities seem to be doing rather well. They still attract more than their fair share of foreign students.

But there are some indications that Britain's share of top-level research is diminishing. Britain won 11 Nobel prizes in chemistry, physics, physiology and medicine in the 1960s, 13 in the 1970s, four in the 1980s and two in the 1990s. Of the past five British scientific Nobel prize-winners, none worked at a British university (they were at the Imperial Cancer Research Fund and government research laboratories). According to Andrew Oswald of Warwick University, only 80 of the world's 1,200 most-cited scientists are working in Britain, compared with 700 in America, whose lead is growing.

Only 80 of the world's 1,200 most-cited scientists are working in Britain

Leaders of the top universities—such as Sir Derek Roberts, provost of University College London (UCL)—are convinced that a crisis is impending. By British standards, UCL has a vast research budget; but it is running a deficit and has lost academic staff to America, though Sir Derek is more worried about the exodus of PhD and post-doctoral students to more remunerative countries. Because of the continual erosion of funding and salaries, he says, prestige institutions such as his are now “living on borrowed time”. To help secure its pre-eminence, UCL is considering a merger, combining with Imperial College, another premier London institution, to create a university with far greater clout than either Oxford or Cambridge.

Across the Thames in unfashionable Elephant and Castle, though a long way architecturally and academically from the academics at work around UCL's neo-classical quad, is South Bank University (formerly South Bank polytechnic). Deian Hopkin, its vice-chancellor, is a passionate advocate of higher education for all. He is, he says, much more worried about standards at the end of a student's course than at the beginning of it. South Bank has an agency to help students find part-time work. It also runs schemes in which employers try to persuade local pupils of the benefits of going to university. But because of a high drop-out rate, and its failure to meet student recruitment targets, South Bank has been obliged to cut academic jobs, and give back some of its grant to the Higher Education Funding Council for England, the primary government funding agency for universities. The problem, says Mr Hopkin, is that institutions such as his have been forced to compete for students and money with old universities that have vastly superior resources.

The government sees the problem but not the solution. It tinkered with funding arrangements in 1998, when it introduced small student fees to cover part of the cost of tuition, and supplement the much larger state subsidy. At the same time, the maintenance grants that students had previously enjoyed were replaced by loans.

One of the stated aims of these changes was to improve access to university for less-well-off teenagers. But the wide gap between the proportions of students who come from the top social classes and the bottom ones hasn't shrunk. Partly because of that, and partly because students and their parents don't like stumping up the cash, the government has come under pressure to scrap the fees (£1,100 for this academic year). In fact, only about 39% of students pay the full (if piddling) amount; 42% of them pay nothing at all. But replacing grants with loans too mean to cover living expenses seems to have frightened off some students. The government is likely to bring back grants under some new name.

Bring back Smith

Economics argue for cutting universities loose from government and allowing them to raise money through fees, for which students could borrow, either privately or from the government. Fees would rise a lot. The government says that the current £1,100 fees cover a quarter of the cost of educating students. UUK says the real cost is higher, and the difference appears in the deficits that around half of Britain's universities are running. Sir Richard Sykes, the rector of Imperial College, recently calculated that Imperial loses £2,800 annually on every undergraduate, and proposed charging the full cost, around £10,500, to students whose families could afford it.

In its last manifesto, Labour promised not to introduce top-up fees, but Tony Blair is now believed to favour them—persuaded, it is said, by Lord Jenkins, a former Labour chancellor of the exchequer, now chancellor of Oxford University. But other cabinet members, such as Gordon Brown, the current chancellor, are reckoned to be hostile. They fear that fees, even if introduced with a state-backed loans system, would put off poorer people.

If ministers shy away from this solution, there is talk that some top universities may decide to cut themselves loose, and do without government subsidy. Adam Smith would approve. He taught at Glasgow University, where academics were paid directly by students, and he thought the teaching was better in such universities than in those subsidised by the church or the state. A teacher's diligence, he observed, “is likely to be proportioned to the motive which he has for exerting it”. Britain's universities have been subjected to socialist centralism for too long. It would be good to bring a bit of Smith back into them.

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House of Windsor

Rebrand or bust

Nov 14th 2002
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Britain's oldest firm is on the rocks. Time for restructuring

A HEADQUARTERS at war with the principal subsidiary, no strategy, dreadful corporate governance and a mish-mash of brands—Britain's leading entertainment conglomerate was in trouble even before the latest shenanigans. Now a combination of amateurish personnel policy, a hideous litigation misjudgment and cack-handed news management have undermined the family partnership to the point that it may go out of business altogether.

There are four urgent priorities for the House of Windsor. The first is to centralise news management. Currently, the Buckingham Palace corporate headquarters is wildly at odds with the troubled St James's Palace subsidiary. A bit of boardroom bickering is inevitable in any company, but fighting it out in the tabloid press is self-destructive. The blood-spattered history of this particular industry shows that if top managers and their aides do not hang together, they may all of them risk the chop.

The second is to seize the initiative and announce a full independent inquiry, chaired by an eminent outsider, into the recent allegations of sexual harassment, irregular handling of corporate gifts, and other ethics violations. This week's decision to have a private investigation by the subsidiary's company secretary, Sir Michael Peat, reassures nobody—and stokes fears that the company's internal audit system is irredeemably skewed by favouritism, self-satisfaction and secrecy.

That will take a few months, and should deflect some of the media frenzy. So will the third priority—a radical restructuring with an emphasis on transparency and efficiency. Like some other famous British brands in neighbouring parts of London (hand-made shoes, suits, shotguns and so forth), House of Windsor profits greatly from tradition and sentiment. But brand values should not be confused with real-world management practice. Like any other organisation, Windsor needs lean but effective management.

Like any other organisation, Windsor needs lean but effective management

Although there have been some efficiency gains of late, reporting lines are evidently muddled and there is still wasteful duplication between the different subsidiaries and brands. This business will never be low-cost, and in past centuries the Windsor top management enjoyed extravagant perks. In the modern world, however, self-indulgence and feudal flim-flam corrode both the company's external image and its internal ethics.

Finally, Windsor needs to consider its product range, currently an uneasy mix of celebrity and utilitarian offerings. Its strongest brand, Queen Mother, was withdrawn from the market this spring. The current leading product, Elizabeth, is looking tired, and has suffered from the recent bout of bad publicity. The troubled Charles brand (run out of St James's Palace) has fared even worse. In the mixed bag of minor brands (Philip, Anne, York and Wessex) even the strong ones offer little prospect of development, while the worst should be dumped forthwith.

The best hope is Wills, a joint-venture product between the St James's Palace and (now-defunct) Kensington Palace subsidiaries. After two decades of development and trial marketing, Wills is nearly ready for a full launch. Early public reaction has been positive. But there will need to be some careful thinking about positioning. Functionality, thrift and good taste are better long-term value propositions than showbiz glitz, which has made the Windsor image tawdry and volatile.

There is an interesting but superficial comparison between Windsor's plight and that of other similarly venerable but mismanaged outfits—the Tory party, Oxford University and the Church of England. Unlike them, Windsor faces no immediate competitive threat; but Windsor must remember that it operates a

franchise which can always be withdrawn.

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Religious controversy

The fundamental things apply

Nov 14th 2002
From The Economist print edition

Britain's chief rabbi is once again under fire

RELIGION can resolve conflicts, writes Jonathan Sacks, chief rabbi of the United Hebrew Congregations of the Commonwealth, in a new book, “The Dignity of Difference”, but it can also cause them. No kidding. Although reviewers have praised his elegantly written plea for tolerance, a handful of ultra-Orthodox Jews in Britain and abroad are on the attack.

Mr Sacks's thought-crime was to say that all faiths are important. “No one creed has a monopoly on spiritual truth...In heaven there is truth; on earth there are truths. Therefore each culture has something to contribute.”

That seemingly bland statement infuriates the fundamentalists. How, they ask, can a champion of Jewish orthodoxy like Mr Sacks say that all religions are equally valid? One rabbi has deemed the book heretical, another says it is not fit to be in a Jewish home. Summoned before a panel, Mr Sacks tried to explain his views on how Judaism relates to other faiths; his inquisitors urged him to correct various “ambiguities” in his book. Mr Sacks insists that nothing in his book contradicts Orthodox Jewish principles. But he has asked his publishers to sell no further copies until an amended version is printed.

The present furore comes hard on the heels of a controversial interview with the *Guardian* newspaper, in which he said that the conflict with the Palestinians was “forcing Israel into postures that are incompatible in the long run with our deepest ideals.” That infuriated the fundamentalists, who believe Israel can do no wrong.

The fuss about the book puzzles Emma Klein, an observer of Jewish affairs: “This is not a big deal. It's about minutiae.” Most Orthodox Jews, she says, would understand and accept the book's arguments, which are noble, and worth standing up for. Standing up is not, however, something that Mr Sacks is entirely comfortable doing at the moment: having put several noses out of joint, the chief rabbi has since broken one of his toes in an entirely unrelated incident involving a piece of domestic furniture.

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House prices

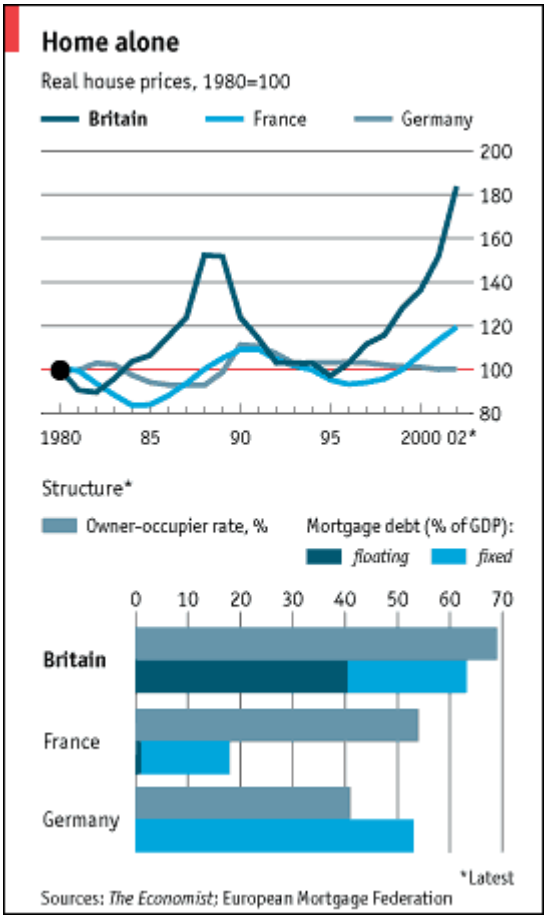
British exceptionalism

Nov 14th 2002
From The Economist print edition

The house-price bubble lengthens the odds against joining the euro

THE Bank of England delivered a stern warning this week about Britain's overheated housing market. Mervyn King, the Bank's deputy governor, spoke on November 13th of “the growing risk of a sharp correction to house prices”. The same day, the Queen's Speech omitted any mention of a bill paving the way for a referendum to join the euro. Spot the link: Britain's house-price bubble makes it much riskier to join the euro in this parliament.

House prices are currently rising at 25-30%—far faster than in the euro area. Once again, Britain is showing that its housing market is the most volatile in Europe. This tendency for house prices to boom and bust has a chequered history. A few other European countries like the Netherlands and Italy come close, but not Germany and France, which together account for more than half of euro-area output. As a result, the European Central Bank pays little attention to house prices when it sets interest rates in the euro area.



Britain's exceptionally volatile housing market reflects three structural features that together make it operate in a very different way to most continental housing markets. The proportion of British households owning their homes is relatively high. Their mortgage debt is especially chunky. And Britain also stands out for the proportion of that debt borrowed at floating rather than fixed rates of interest.

With house prices so volatile and property-backed credit readily available, the housing market drives the British economy to a much greater extent than occurs in the euro area. At present, for example, mortgage equity withdrawal—money borrowed on property but not invested in it—has jumped to 5.9% of household post-tax income, the highest since 1988. Without this injection of borrowed funds, the consumer boom would be running out of steam. Instead, consumer spending—which accounts for two-thirds of GDP—continues to grow by around 4% a year, much faster than the economy. Along with the government's public spending spree, a buoyant housing market is a principal reason why the British economy has weathered the economic setbacks of the last two years so much better than the euro area.

House prices are already 25-30% over-valued in relation to income

But all parties come to an end. The Bank of England's central projection is that house-price inflation will subside to zero by the end of 2004. But in its quarterly *Inflation Report*, it warned this week of “a more abrupt slowdown” if current extraordinary rates of house-price inflation carried on for much longer. House prices are already 25-30% over-valued in relation to income, their main long-run determinant, according to John Hawksworth, an economist at PricewaterhouseCoopers, an accountancy firm.

When the bubble does burst, the consequences will be severe. In effect, the boom has brought forward consumer spending, which has grown faster than the economy for seven years. What lies ahead, by

contrast, is a period of retrenchment as households repair finances that have become top-heavy with debt. The ensuing slowdown in consumer spending will act as a drag on the economy and tax revenues. Mr Hawksworth warns of “an end to the feel-good factor, a sluggish economy and a shortfall in expected tax revenues”.

This would be an unpropitious backcloth to a decision to join the euro. When Gordon Brown first set out the five tests for euro-membership in 1997, the Treasury expressed the hope that greater economic stability—since achieved—would tame the housing market. Some hope. Now it is studying the issue intensively as part of its new assessment of the five tests, due by next June at the latest. No wonder. If the housing market continues to boom, then locking currencies, say in 2004, would make matters worse, since interest rates could no longer be higher than in the euro area. This could cause the market to over-shoot still further, making a subsequent collapse more severe. But even if the boom is already turning to bust, joining the euro would also be extremely risky since British interest rates might then need to fall below euro-area rates in order to nurse an economy suffering from a debt overhang and weak consumer demand. “In the aftermath of a bubble you need the maximum of flexibility but entering the euro area would put you in a straitjacket,” says Darren Winder, economist at UBS Warburg.

Britain's volatile housing market wreaked havoc for the Tories. Now it threatens to do the same to Tony Blair's plan to get Britain into the euro.

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Strikes

Wage slips

Nov 14th 2002
From The Economist print edition

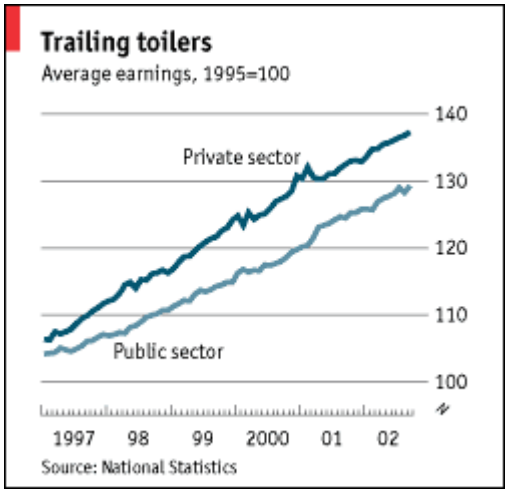
Strikes are the symptom of something badly adrift in the public sector

KEEPING large numbers of poorly paid employees happy is never easy at the best of times, and these are not the best of times in the public sector. As well as the firemen's strike that started this week, there have been or are likely to be strikes in local government, schools, colleges and universities, the ambulance service, the courts, the post office, the railways and possibly air-traffic control. This year looks like being the worst for labour unrest in the past decade.

There are three main reasons. London, where many of the disputes are happening, is one. Pricey housing and transport in the capital make low pay especially hard to bear. Local government workers, for example, want their cost-of-living supplement raised from the current maximum of £2,600 to a flat-rate £4,000.

The second is that the government's splurge on health and education means that there is more money in the trough. Given that public-sector pay has been lagging behind private-sector pay for years (see chart) workers are understandably keen to catch up.

The third is crossness about changes. Public sector management, especially in local government, is often bad. Reforms, such as the contracting out of cleaning services, bring with them new working practices and often lower wages for workers who were already miserably paid.



Some of the complaints are overdone. Pay is lower in the public sector, but there are big compensations: generous index-linked pensions; a relaxed approach to timekeeping, sickness, holidays, early retirement etc; iron-clad job security. It is hard to recruit and keep some sorts of people in some parts of the country (finding a good receptionist for a doctor's practice in London is a nightmare, for example). But for most jobs—and particularly with a recession looming—supply and demand look in rough balance.

The government's approach is to fix long-term pay deals, and make salary structures more attractive for the ambitious and able. There have been more than 20 agreements covering two or more years in the past 18 months. According to Incomes Data Services, a consultancy, most are three-year deals worth 15-23%. With inflation comfortably under 2%, that is pretty decent—and a lot better than many private-sector workers can look forward to.

Fixing public-sector pay centrally is never going to work very well, though. It encourages jealousy and spurious comparisons, and detracts attention from the two factors that should determine pay: local labour market conditions, and performance. Decentralised pay bargaining would be much better. This is already happening: rich local councils, for example, find ways of paying sweeteners to get the staff they need; so do richer bits of the education system, such as some Oxford and Cambridge colleges. Although the unions claim to want flexibility, they would hate a real challenge to centralised bargaining.

The real—but very tricky—answer is to run the public sector better. If productivity there was not so low, public services would need fewer workers, who could be better-paid. Making that happen would be worth a few strikes. Sadly, it looks more likely that extra money will trickle away, in wage increases and other inflated costs. And nobody will be any happier.

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Crime

Yob off

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New laws don't necessarily stop crime. Look at the last lot

FORGET Iraq. The victory Tony Blair wants, judging by the number of government-inspired headlines in past days, is in the war against yobs. Petty crime, drugs, drunkenness, vandalism, graffiti and litter are high up the list of public worries, and an attack on anti-social behaviour is the centre-piece of the legislative programme outlined this week.

A new bill will enable quicker, more effective action against disruptive tenants and the parents of truanting children. It will also allow police to dish out fixed-penalty notices for a range of petty crimes from drunkenness to vandalism.

The cynical response is that we have heard it all before. Since Labour came to power, it has enacted more than a dozen criminal justice acts. “It is time to end yob culture”, the prime minister told the Labour Party conference two years ago. Since then the war against yobs has spawned hundreds of headlines, though on the front line, little or nothing has changed.

Labour's previous big effort, the 1998 Crime and Disorder Act, introduced anti-social behaviour orders (ASBOs). A civil penalty, thus requiring lower standards of proof, these were designed to deal with those tenants who persistently make life a misery for their neighbours. They can take many forms, from banning repetition of certain conduct to prohibiting teenagers from gathering on an estate.

Paul Cavadino, director of NACRO, a charity concerned with penal policy, points out that the results so far have been disappointing. The new orders, he says, “have been cumbersome, bureaucratic and costly”. On average, each one costs more than £5,000 and takes over three months to obtain. A Home Office review found that more than a third were breached within nine months of being granted. As a result, many local authorities have been reluctant to use them. In the past three years, only 200 ASBOs have been issued annually.

The reaction of ministers is to blame local authorities for failing to use their new powers. “People are sick and tired of hearing that laws have been passed and nobody enforces them,” says the home secretary, David Blunkett.

But some authorities say that experience shows prevention rather than confrontation is more effective in tackling anti-social behaviour. Islington in London has pioneered the use of acceptable behaviour contracts and parental control agreements, which involve the whole family. Knowsley on Merseyside has introduced a mentoring scheme for young offenders.

Policing in Britain has traditionally been by consent. But many estates become vandalised jungles exactly because there is no consent and witnesses are frightened to come forward. Enacting more and more laws will not change such deeply entrenched behaviour. Without consistent enforcement of existing laws—which involves the better guarding of public space, whether by special wardens, or more police—the war against yobbos will fail.

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Bagehot

It's much too soon to gloat

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The absence of opposition has made the government conceited. But it is not as powerful as it thinks it is

A WEEK ago government ministers were under instructions not to gloat too much at the poor old Tories. Perhaps not surprisingly, Downing Street seemed intent on preserving Iain Duncan Smith for the nation. But there was another, better, reason why Tony Blair should have wanted to keep the gloating under tight control. The voters don't much like governments that get above themselves. They don't share their ideological certainties and they fear the consequences of untrammelled power arrogantly exercised. Although the sleaze, divisions and incompetence of the Major years destroyed respect for the Tories, the reason they are still hated by many people is the swaggering triumphalism of high Thatcherism.

Unfortunately, although Mr Blair sort of understands this, he can't help himself. On Wednesday, rather than concentrate on justifying the legislative programme outlined in the Queen's Speech, Mr Blair revelled in the latest bout of Tory in-fighting. His theme was that the Tories were “irrelevant” and his sub-text that the government could do as it pleased.

The trouble with gloating is that it very rapidly leads to self-delusion. Just as Margaret Thatcher wrongly thought she had transformed Britain into an “enterprise culture”, so the government now appears to believe that the voters' conversion to the cause of huge tax-funded increases in public spending is complete. Any suggestion that there may be dangers in the government's ever more aggressive redistributionist tax policies, its carefree imposition of what the CBI rightly calls “policy-driven cost increases” on business and its willingness to throw lots of money at yet-to-be-reformed and highly-unionised parts of the public sector is met with something close to incredulity: “Sorry old chap, but don't you realise, we've won those arguments. Wake up and smell the coffee.”

The government now appears to believe that the voters' conversion to the cause of huge tax-funded increases in public spending is complete

In a sense, of course, they have. Labour won its second term with an explicit promise to deliver a transformation in the quality of public services. When the chancellor, Gordon Brown, announced in the spring that he was raising taxes on middle-income earners to help pay for a 43% real terms increase in health spending over the next five years, his personal poll ratings soared. At no time since has the government relinquished its large opinion poll lead over the Conservatives. So rattled is Tory confidence that nobody quite knows whether the party thinks the government is taxing and spending too much or not. Self-styled Conservative modernisers, such as Archie Norman, even argue in favour of higher taxes (higher than what isn't clear) if that's the price of showing that the Tories really have learned to love public services. As for the Liberal Democrats (despite their silly claim to be the main party of opposition), they praise the government for adopting their own tax-and-spend agenda. The lack of any serious day-to-day opposition is already corrosive enough of good governance, but the real killer is that the government no longer fears the possibility of retribution at the hands of the electorate. When even senior Tories define success as limiting Labour to a majority of fewer than a hundred seats at the next election, it's hardly surprising if the government is carried away with the sense of its own dominance.

Yet in many ways, the government is more constrained than the daunting parliamentary arithmetic and the wretchedness of the Tories imply. Above all, its mandate for tax and spend is a good deal more conditional than it currently likes to think. Because, during its first four years in office, it was seen to run the economy sensibly, the electorate decided that it had earned a freer rein in its second term. Although, if opinion polls are to be believed, voters were sceptical about the chances of success, they were nonetheless willing, in effect, to acquiesce in the government's attempt to discover whether the old model of public services could be fixed with decent funding and a few tweaks. If Mr Brown's budget was

popular, it was because he appeared to be doing what the government said it would do.

Now for the hard part

But from now on things can only get tougher. The fire-fighters' strike has dramatically illustrated both the intensity of union-led opposition to any changes in working practices and the danger that most of Mr Brown's billions will be swallowed by higher pay. Even the 11% offer proposed by the independent Bain Commission (rejected by the fire-fighters as “derisory”) would be disastrous if it were extended to more deserving or hard-to-recruit workers, such as nurses. When the chancellor's tax hikes take effect in April, against a backdrop of rising union militancy, the government is likely to find the appetite for more of the same to be distinctly limited, particularly as it is quite likely that these will coincide with the onset of the deepest house-price recession since 1989. Up till now, Mr Brown's squeeze on the incomes of the affluent middle classes has been tolerated because rising house prices have bolstered living standards. With university top-up fees also looming, it may not be for much longer.

The Queen's Speech was full of proposals for legislation to pave the way for the structural reforms in health and education on which the prime minister is pinning his hopes. But these are coming very late in the day and may yet be undermined by a lethal combination of union hostility and sniping from Mr Brown, who increasingly puts himself on the side of equity rather than efficiency. With public patience already wearing thin, it will be years before these proposals make an impact. The truth is that this government has not until now experienced real adversity: it has yet to be tested. It has enjoyed the fruits of a benign economy, industrial peace and, best of all, the benefit of the doubt. But the going is about to become a lot rougher. Even without an opposition worthy of the name, failure is a real possibility. As Mr Blair in his less hubristic moment knows only too well.

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A divided self

Nov 14th 2002
From The Economist print edition

Reuters

France has an identity problem. It needs to find the courage to redefine itself, says John Andrews

"I HAVE heard and understood your call: that the republic should live, that the nation should reunite, that politics should change." On a cold evening in early May, Jacques Chirac found the right words for the moment. He had just been re-elected president of the French republic, with 82% of the vote, in a run-off with Jean-Marie Le Pen, the leader of the extreme-right National Front. Two weeks earlier, in the first round of the election, Mr Le Pen had eliminated the Socialist candidate (and incumbent prime minister), Lionel Jospin, from the contest. For left-leaning voters, Mr Chirac was clearly the lesser evil, so in the run-off they joined forces with Mr Chirac's centre-right to humble Mr Le Pen. Hence Mr Chirac's carefully chosen words: his victory may have been sweet, but it was hardly unqualified.

Doubtless that is why as prime minister of his "government of mission", Mr Chirac appointed Jean-Pierre Raffarin, a pudgy and amiable former senator from the Poitou-Charentes region. Mr Raffarin's motto is *la France d'en bas*, grassroots France, which is supposed to mean not only a government closer to the people but a government that comes from the people.

So six months later, is the nation "reunited"; has politics changed; is the republic "alive"? The answers are horribly muddled, mainly because the French themselves are muddled: over France's place in Europe, over the impact of globalisation and, at root, over what it means to be French. In their hearts they want precious little to change; in their heads they suspect change is inevitable.

If it is, their worry is not just what the change will be, but how and when it will come. On June 17th, the day after a parliamentary election in which Mr Chirac's supporters (most of them members of the newly assembled and aptly named Union for the Presidential Majority) won 399 of the National Assembly's 577 seats, the headline of the conservative *Le Figaro* proclaimed: "Five years to change France". Given that there will be no significant elections before the next presidential and parliamentary polls, due in 2007, the opportunity is there. But if change does come, many will not like it: the leftist *Libération*'s headline sarcastically predicted "A five-year sentence".

Whatever the headlines say, for most of France's 59m people not much has changed since the bout of

elections in the spring. Around 9% of the workforce is still without a job; the rest troop off to their offices and factories just as before, cosseted by laws that protect them from quick lay-offs, provide them with one of the world's shortest working weeks—just 35 hours—and give them holiday entitlements Americans can only dream of. Meanwhile, their country remains as beautiful and seductive as ever, and the two-hour lunch is alive and well. Add trains that run fast and on time, modern motorways in good repair, and a medical system at the top of the World Health Organisation's international rankings. Surely the French have a right to feel pleased with themselves?

Not altogether superior

So why do they feel so insecure? Why do politicians, pundits and philosophers (a breed revered on French television) feel a need to bolster the country's collective morale by pointing out the deficiencies of the “Anglo-Saxon” way, be they fraudulent accountancy practices in America or decrepit private railways in Britain?

One reason is doubtless a dash of *Schadenfreude.* Within the lifetime of its senior citizens, France has been occupied by Germany, rescued by America and Britain, and then divested—bloodily in the case of Algeria and Indochina—of almost all its colonies. Since then English has become the world's common language (so much so that France's own politicians will now speak it in public), America has turned into the world's only superpower and Hollywood has come to dominate the world's entertainment industry. For France, a country which believes that its revolution, just as much as America's, bears a universal message, these changes have not been easy to accept. Seeing someone else having a hard time provides some light relief.

But there are also more troubling reasons for this lack of confidence. One is the feeling, especially among industrialists and businessmen, that France's economic formula, involving higher taxes and social charges than in most of the countries its firms compete with, will not work forever. Indeed, it is already fraying at the edges. At the start of the 1990s, France ranked eighth in the world in terms of economic output per person, but by the end of the decade it had slipped to 18th.

The most important reason, however, is a lurking suspicion that French society itself is not working. Go back to the first round of the presidential election on April 21st, with its 16 candidates, and ask a few simple questions. Why did Mr Jospin, arguably France's most effective prime minister in the 44 years of the Fifth Republic, get only 16.2% of the vote? Why, in that round, did Mr Chirac get only 19.9%, the lowest ever for an incumbent president? Why did 13 no-hoper candidates gather up 47% of the vote between them? And why did a record 28.4% of the electorate abstain? Most bothersome of all, why did Mr Le Pen, ostracised throughout his 40-odd years in politics, win 16.9% of the vote and so pass through to the second round?

There are plenty of superficial answers: Mr Jospin lacked charm; Mr Chirac was stained by alleged corruption; the electorate felt free to indulge its whims because it assumed that a run-off between Messrs Jospin and Chirac was pre-ordained; and Mr Le Pen is a brilliant orator. But there is a more fundamental explanation. As one French journalist, Philippe Manière, puts it in a recent book, the first-round result was “the vengeance of the people”.

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Same bed, different dreams

Nov 14th 2002
From The Economist print edition

Better to cohabit than be out in the cold

IS IT sensible for France to have a president from one side of the political divide and a government from the other? Olivier Schrameck, chief of staff to Mr Jospin from 1997 until May this year, devoted much of a recent book, “Matignon Rive Gauche, 1997-2001”, to denouncing such “cohabitation” as a waste of energy and a recipe for immobility. Under cohabitation, the government would run the country, but the president, who retains traditional authority over defence and foreign policy (the constitutional authority is rather vague), would be tempted to snipe from the sidelines.

Yet French voters have forced such liaisons on their country three times since the birth of the Fifth Republic in 1958. The first time was when the left was defeated in the parliamentary elections of 1986. The Socialist François Mitterrand, who had been elected president in 1981, had to put up with a centre-right government led by Jacques Chirac as prime minister. In 1988 Mitterrand was re-elected president and dissolved parliament. In the ensuing elections the Socialists returned to power. In 1993, however, the left-wing government was voted out and Mitterrand had to cohabit with the centre-right once again, this time with Edouard Balladur as prime minister. Two years later this cohabitation ended with the election of Mr Chirac as president. But in 1997 Mr Chirac provoked the third cohabitation—much tenser than the first two—by calling early parliamentary elections that the left, led by Mr Jospin, won handsomely.

Such cohabitations could happen because the presidential term was for seven years and that of the lower house of parliament, the National Assembly, for five. But in future there will be less opportunity for these oddball relationships. In September 2000, after an arcane debate between constitutional experts and self-interested politicians, a bemused electorate decided in a referendum (in which only 30% cast a vote) that, beginning with the elections of 2002, the president would have the same five-year term as the parliament.

Since a president might die in office, or might dissolve parliament early, there could still be cohabitations in the future. But as long as President Chirac remains in the post, he is unlikely to call early elections again. For the record, he used to be a fierce opponent of reducing the seven-year presidential term, but changed his mind. His critics say he feared that voters in 2002 might think him too old for another seven-year term but young enough for five years (he will be 70 later this month). He himself claims he supported the change in order to modernise France.

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A question of colour, a matter of faith

Nov 14th 2002
From The Economist print edition

France must face up to its immigrant problems

JEAN-MARIE LE PEN, at ease in his drawing room, waves an arm as if to state the obvious: “The greatest challenge is demographic. The countries of the north—the world of the white man, or let's say the non-black world—have an ageing population. They are rich, and they are facing a third world of 5 billion people, maybe more tomorrow, who are very young and dynamic. This dynamism will be translated into immigration.”

AP

The world according to Le Pen

Outside the room, the guard-dogs are asleep. In the urban plain below the Le Pen mansion (inherited from a political admirer) in Saint-Cloud, the Paris evening rush-hour is under way. The National Front leader goes on: “The rise of Islam is more the result of its youth and dynamism than its religious values. It's a demographic problem which will lead to immigration, whose consequences could lead, if nothing is done, to the submersion of our country, our people, our civilisation...No government, whether by ideology or by blindness, has realised the danger.”

France's far-right bogeyman gained second place in the presidential election by saying what few other politicians would either want to or dare to: that the French republic has too many immigrants, who in turn have too many children. But that is putting it politely. What the National Front and the National Republican Movement, its rival on the extreme right, really mean is that France has too many inhabitants who are black, brown and Muslim. And lots of them are not immigrants at all, but were born in France and are French citizens.

There are plenty of other politicians who have dabbled in the politics of race. Governments of the right have over the years enacted increasingly strong laws to restrict immigration, and governments of the left have for the most part accepted them. Mr Chirac, definitely not a racist himself, found it useful in the 1988 presidential election campaign to refer to the “odours” of immigrant cooking.

What makes Mr Le Pen different is that he has consistently preached the same xenophobic message ever since he entered politics. He became France's youngest member of parliament in 1956, at the age of 27, and first stood for the presidency in 1974. France's ills, he has said all along, are the fault of foreigners, including fellow members of the European Union. The remedy is to keep out foreigners, produce more French children, build more prisons, cut taxes and leave the EU.

The question is why that message suddenly found more resonance with the voters in last spring's presidential election than ever before in Mr Le Pen's political career. Mr Le Pen's previous best score was 14.4% in the first round in 1988, and the only time his party has ever gained more than one seat in the

National Assembly was in 1986, when the elections, exceptionally, were held by proportional representation.

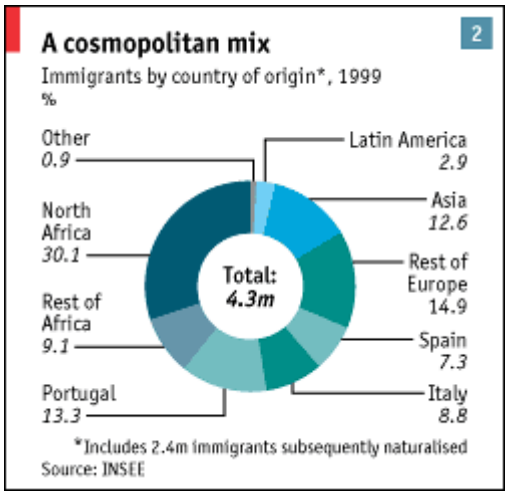
The answer is surely not that nearly a fifth of the voters suddenly decided that Mr Le Pen's programme made practical sense, nor that all those who cast their ballot for him are anti-Semitic fascists (Mr Le Pen has described the gas chambers as a “detail” of the second world war, and thinks that Maurice Papon, the Vichy official who in the late 1990s was eventually convicted for crimes against humanity, was innocent). More likely, the voters wanted to jog the governing elite into action. As a former Socialist prime minister, Laurent Fabius, once said, “Le Pen poses good questions and offers bad solutions.”

So what might a good solution look like? A useful start would be, literally, to enumerate France's problems. Malek Boutih, the French-born son of Algerian immigrants and now the president of SOS-Racisme, an anti-racism organisation, argued in a recent book that “France is wrong not to publish, as other countries like America do, statistics of criminality by social category, age, place, type of city development and so on. It is even more wrong not to establish a public debate on the question, as though the French are so irrational that they cannot calmly consider the reality of their problems.”

Crime matters

But should that mean a debate on crime as well? Polls before the election showed that the subject topped the list of their concerns, ahead of the state of the economy or pensions or even unemployment. Whether crime in France is worse than in other countries is a moot point: criminal statistics are hard to compare, and although one study showed that France in 2000 had proportionately more crimes than America, other studies suggest that it did a little better than, say, Germany or Belgium. However, what matters to French people is what happens in France.

Or more precisely, what they think is happening. Nicolas Sarkozy, the interior minister, has won plaudits for not only identifying crime as a serious problem but being seen to be doing something about it. Barely a week goes by without him being photographed with a smiling collection of police or gendarmes. Mr Sarkozy has secured the money to add another 6,500 police to the 146,000 he took over from his predecessor. And Mr Raffarin has appointed a junior minister in the justice ministry specifically to supervise a building programme that will add 11,000 prison places to the 47,000 already occupied.



In terms of public perception, such measures will help. One poll in September found that the proportion of those questioned who felt they were “often” at risk of crime was 49%—shockingly high in absolute terms but actually slightly less than in the autumn of last year. Mr Sarkozy has been able to trumpet a reduction in reported crime, by 4.5% in August compared with a year earlier, the first such fall for five years. In Paris, where the tourist industry has long complained about the plague of pickpockets, the fall was 11%.

Whether the momentum can be sustained is another matter. In the country that produced the Declaration of Human Rights (in 1789, a satisfying two years before America's Bill of Rights), the new enthusiasm for “zero tolerance” becomes hard to swallow when it means giving the authorities greater powers of arrest and punishment.

According to critics, many of them well placed in the judiciary and the media, the government is eroding the presumption of innocence (never particularly robust in France, which has no Anglo-Saxon protection of *habeas corpus*); it casually treats many young offenders as though they were adults; and it is callously cracking down on France's most marginal residents, from Romanian beggars to African prostitutes. In other words, the critics allege that the Raffarin government—and Mr Sarkozy in particular—is doing the work of Mr Le Pen for him.

Press Mr Boutih on whether criminal statistics should include a breakdown by race or religion, and he immediately says no: “I remain convinced that ethnic origin is less relevant than the level of education and social status.” He has a point: a well-educated Arab or black Frenchman with a decent job is unlikely to turn to petty drug-dealing or car-stealing. The trouble, according to Tahar Ben Jelloun, a Moroccan

who is one of France's finest writers, is that only 4% of the children of immigrants get to university, compared with 25% of their native contemporaries.

Our ancestors the Gauls

But the main reason for Mr Boutih's resistance is that to collect information by race or religion would offend the very French concept of “republican values”, because it would discriminate between citizens rather than treat them as equal. France makes no allowance for cultural differences: “our ancestors the Gauls” applies to schoolchildren of every hue. In this secular republic, the idea of collecting racial and religious statistics is a virtual taboo across the whole of the political spectrum. Such statistics, it is feared, will lead France along the Anglo-Saxon road of “communautarisme” (in which the idea of separate communities within the country as a whole is acceptable). In the words of the constitution, the French republic is indivisible, and having separate communities is seen as automatically leading to divisions.

Yet the sad reality is that France's race relations are no better than anyone else's. Arab and black minorities are as much as ever excluded from the mainstream. In opinion polls in the late 1990s, two-fifths of the respondents admitted to being at least “a little bit” racist (more than in any other European Union country except Belgium), and just over half thought there were “too many Arabs” in France.

The lack of solid figures leads to the sort of guesswork that plays into the far-right's hands. The state statistics office, INSEE, reckons that in 1999 (the year of the most recent census) the total number of foreign-born residents in metropolitan France, including 2.4m who have acquired French nationality, was 4.3m, or 7.4% of the metropolitan population of 58.5m. Of these, 1.3m had come from Algeria, Morocco and Tunisia. But the official figures end with that breakdown by country of origin.

The best estimate for the religious breakdown that INSEE is not allowed to publish comes from a scholarly report presented to the prime minister two years ago by the High Council for Integration, a committee of academics and experts. The report reckoned that France is home to 4m-5m Muslims—defined by culture rather than religious observance—of whom up to half have French nationality. Of the Muslim total, almost 3m are of North African origin or ancestry, with 1.5m from Algeria, 1m from Morocco and the rest from Tunisia. Of the other Muslims, Turks probably number 350,000, sub-Saharan Africans about 250,000, and assorted Middle Easterners (Iranians and Kurds, as well as Arabs) the remainder. So France's Muslims make up at most one in 12 of the population—and its Arabs one in 20.

Yet the media keep repeating that there are at least 6m Arabs in France, and quite possibly as many as 8m, who are regularly accused of crime, vandalism, the abuse of social services and other wrongdoings. It is easy for the elite and the comfortable middle classes to dismiss Mr Le Pen's view of the world, but less so for those—especially *les petits blancs* (poor whites)—who live in crime-ridden working-class neighbourhoods. According to the analysts, in the first round of the presidential election Mr Le Pen won the support of only 8% of those with a college education, but 30% of blue-collar voters and 38% of the unemployed.

Chronic or curable?

Pessimists argue that the situation will get worse before it gets better. France's high rate of unemployment is not about to tumble overnight. Nor are the high-rise public housing blocks built from the 1950s to the 1970s in the *banlieue*, or suburbs, of most French towns. At the time, they were intended to provide affordable housing to the influx of workers from the countryside and from the colonies or ex-colonies. Now they have all too often become virtual ghettoes, each storey dotted with satellite dishes pointed towards the television stations of the Maghreb. But the problem extends far beyond the *banlieue*. The same combination of poverty, race and social exclusion can be found in the medieval villages of Provence, or in some down-at-heel parts of Paris such as the 10th or 19th *arrondissements*.

The passage of time, say the pessimists, is not healing cultural rifts but making them worse. The generation of immigrants from the Maghreb were often illiterate peasants, keen to work hard in a country whose language they could barely understand. By contrast, their children, and now their children's children, are French-born and French-educated, and have lost respect for their immigrant parents or grandparents. That has caused a loss of parental authority, and often a multitude of behavioural problems in the disciplined world of French schools.

How French can you get?

Moreover, being French-born and French-educated does not mean that an Abdel-Karim or a Samira will be treated the same as a Jean-Pierre or a Marianne. To be white and born in France of French parents and grandparents means you are a *Français de souche*—of "French stock". But to be born in France of Arab ancestry makes you a *beur*, a word which for most Arab Frenchmen has no pejorative undertone (there is, for example, the Beur-FM radio station). The word is a kind of inversion of the word *Arabe*, part of an argot of inversion called *verlan* (*l'envers*, or back-to-front), which turns *français* into *cefran* and *café* into *féca*. This is undoubtedly of linguistic interest, but the language is also a sign of exclusion, sometimes self-imposed. *Beur* is now so universal that the new word among the *beurs* is *rebeu*, a *verlan* of a *verlan*.

How to end that exclusion? In America the answer might be affirmative action or positive discrimination, but in France such notions are seen as a threat to a republic which presumes its citizens to be free, equal and brotherly to begin with. When Sciences-Po, an elite university, last year began a special entry programme for a handful of bright students from the "zones of priority education" in the *banlieue* around the cities of Paris and Nancy, current and former students reacted with horror: their beloved meritocratic institution was slipping down the Anglo-Saxon slope.

Mr Boutih understands the gap between republican theory and everyday practice all too well: "The republican model is not a natural one. It exists through political will. Communautarisme is the natural model." So why not adopt the natural one instead? "Because society will explode from within. Each community will define itself against another, as in the United States."

Arguably, that process is already under way. In October last year, at a soccer match in Paris between France and Algeria, young *beurs* greeted the French national anthem with a storm of whistles and later invaded the pitch, brandishing Algerian flags. Young *beurs* are increasingly turning to Islam, not so much as a faith but as a symbol of identity: they fast during the month of Ramadan, insist on religiously correct food in their school canteens and stay at home to mark religious holidays.

A small minority go a lot further, falling under the influence of extremist imams from the Gulf or North Africa. In their fight to dismantle al-Qaeda, Europe's and America's intelligence services have uncovered a disturbing number of French suspects, not least Zacarias Moussaoui, currently on trial in America for his alleged role in the September 11th attacks on America last year. And a number of young *beur* layabouts have used the excuse of the Arab-Israeli conflict to indulge in anti-Jewish violence and vandalism (at over 600,000, France's Jewish minority is Europe's largest).

The *Français de souche* are accomplices in this process, not just in the April 21st vote for Mr Le Pen or in their reluctance to offer Arabs (and blacks) the same job prospects as whites, but also in the open antagonism some of them display towards the Arabs in their midst. To justify their stance, they quote the inferior status of Muslim women, or the dreadful gang-rapes of "easy" Muslim girls that some Muslim boys regard as a rite of passage. It is no accident that Oriana Fallaci's book "The Rage and the Pride", an extremist tirade against Muslims in general and Arabs in particular, spent so many weeks on this year's French bestseller list.

Could the pessimists be wrong? Back in 1998, France rejoiced in the World Cup victory of a French soccer team starring plenty of blacks and *beurs* (including the incomparable Zinedine Zidane, born of Algerian parents in the Marseilles *banlieue*). Sami Naïr, an Algerian-born member of the European Parliament and formerly an adviser on immigration to the Jospin government, points out that in an earlier wave of immigration into France, in the early part of the 20th century, Roman Catholics from Italy and Poland were accused of "trying to impose religion on our secular state". Yet in the end, he says, the discrimination fades and the newcomers' descendants end up as *Français de souche*: "I think it will be solved in a generation."

Yet there is an obvious difference between the present wave of migrants and previous waves: the *beurs* and their parents are the first minority that can be physically distinguished from the *Français de souche*. Their assimilation cannot be achieved by fading into the background. Instead, Mr Naïr proposes a pact: the government must live up to the values of the republic when dealing with its Arabs—and the *beurs* must accept the duties that go with them, including equality of the sexes. That might be easier if the economy could deliver more jobs.

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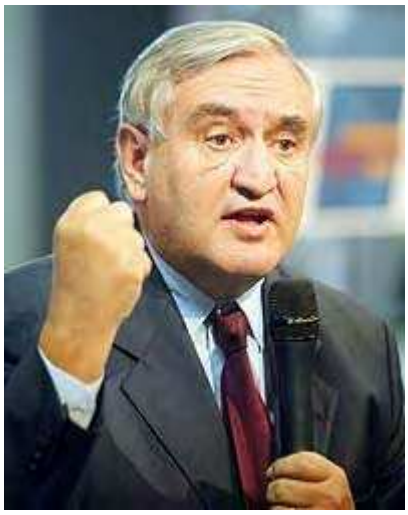
A new kind of solidarity

Nov 14th 2002
From The Economist print edition

France needs more jobs and less state. The two are not unconnected

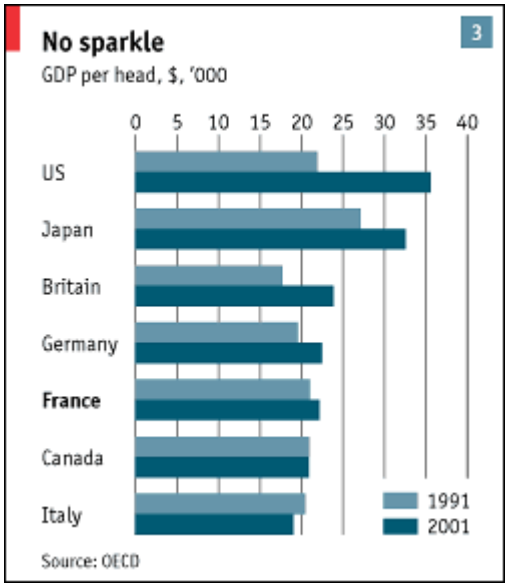
EPA



Raffarin has his work cut out

NOW is not a good time to be prime minister of France, and Jean-Pierre Raffarin knows it only too well. The world economy is in the doldrums, and the French economy is becalmed with it; investor confidence is low; and the trade unions are restive. Last month, for example, thousands of public-sector workers (80,000 according to the unions; 40,000 according to the police) marched through the centre of Paris to defend their privileges as public servants or agents of the state, and to denounce modest plans for privatisation. On the same day, INSEE, the government statistical office, announced that economic growth for this year was now likely to be only 1%, compared with its forecast in June of 1.4% (and the previous government's self-serving prediction of 2.5% before the elections).

If INSEE is right, then the budget for next year presented in October by the finance minister, Francis Mer, becomes an exercise in fiction. It assumes growth of 1.2% this year and 2.5% next, and a budget deficit of 2.6% of GDP. Instead, the deficit could well break through the 3% limit set by the European Union in its collective quest for economic stability. In other words, crisis looms: the EU will want French belts to be tightened, whereas the voters, worried about their jobs and mortgages, want them loosened.



Engraved in the country's political consciousness is the memory of 1995, the last time a centre-right president was elected with a centre-right majority in parliament. The prime minister of the day was the intellectually brilliant but aloof Alain Juppé; he was determined that France should qualify for membership of the euro zone, which meant keeping the franc closely in line with the D-mark while simultaneously cutting the budget deficit (then running at 5% of GDP). This he hoped to do by reforming the public sector, which would restrain public spending. Instead, he saw hundreds of thousands of public-sector workers taking to the streets in a wave of protests and strikes, with the sympathy of most of the population. Two years later, when President Chirac rashly called an early general election to obtain a popular mandate for the EU's single currency, the right was swept from power.

Not surprisingly, Mr Raffarin and his colleagues are keen to prevent history repeating itself. Their strategy is to tread softly, even to speak softly. In opposition, the right accused Lionel Jospin of “immobility”. Now the bosses' association, Medef (Mouvement des Entreprises de France), lays the same charge against Mr Raffarin: it accuses him of being too timid in dealing with the consequences of the 35-hour working week, introduced by Mr Jospin (who cut it from 39 hours with no loss of pay), or with the previous government's “Law on Social Modernisation” (which makes it harder than ever for employers to fire people, thus discouraging them from hiring in the first place). The bosses fear that if Mr Raffarin shows the same timidity in other areas, notably slimming down the civil service and reforming pensions, the country will continue its slide down the international scale of GDP per person.

Just as this is a bad time for Mr Raffarin to be prime minister, the previous period was a good time for Mr Jospin. The world economy, powered by America and its dotcom infatuation, was growing strongly, and France, the world's fifth-biggest exporter, reaped the benefits. A series of partial privatisations (or

“openings of capital”, in the words of Mr Jospin, an ex-Trotskyist well aware of the need to placate the Communists in his coalition) helped to keep the country's finances in excellent shape. Inflation, the public debt and the budget deficit were all low, and economic growth in 1998-2000 averaged 3.3% a year. Successive finance ministers basked in the plaudits of the International Monetary Fund and the OECD.

Growing jobs

All this may have encouraged Mr Jospin to believe that full employment had become a realistic target for France. Certainly a report in December 2000 by Jean Pisani-Ferry, of the Council of Economic Analysis, a body of experts set up by Mr Jospin to give him independent advice, seemed to be suggesting as much. The report noted that in the four years from the start of 1997 France had created 1.6m jobs, “twice as many as during the 1960s and ten times the number created between 1974 and 1996”. The drop in the jobless, it said, was “unprecedented”.

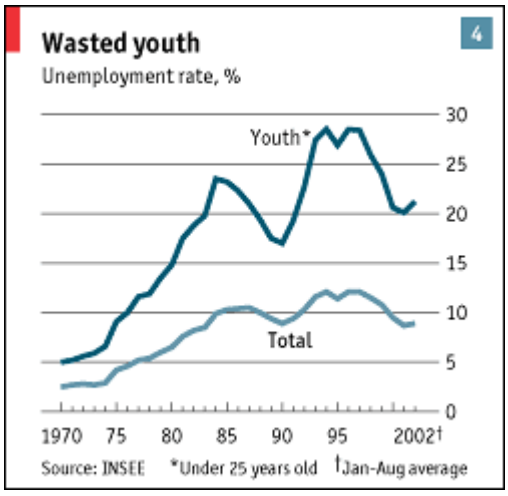
The government was keen to take the credit. In the run-up to this year's elections, it claimed that the 35-hour week, which came into effect in February 2000 for firms with more than 20 employees (it has yet to be fully applied to small firms), had already created 400,000 jobs. The idea was that to compensate for the shorter week, bosses would have to take on more employees, and could be encouraged to do so through temporary relief on their payroll taxes. The government noted, too, that 320,000 young people had found work since 1997 through the youth employment scheme, under which young people were given five-year contracts in the public sector, for example as school playground assistants or as guards at railway stations and other public buildings. At the beginning of 2001 the government had also taken steps to lessen the poverty trap, in which recipients of state benefits lose out if they take a low-paid job.

A success of sorts

But how much of the credit for all these extra jobs did the Jospin government really deserve? On closer scrutiny, the Pisani-Ferry report reads less like a congratulatory pat on the government's back and more like a warning that things must change. For a start, much of the job creation was simply the result of economic growth. Further, full employment was defined as a jobless rate of 5% or less of the workforce, a rate that in happier days for the world economy would have been considered fairly disastrous in, say, Japan or Singapore. The report also argued that to achieve this target by 2010, the country would have to create at least 300,000 new jobs a year, perhaps as many as 400,000.

That, however, would require large-scale liberalisation, of the sort introduced by Margaret Thatcher, Britain's radical prime minister of the 1980s—and French vested interests are most unlikely to allow that to happen. Besides, there is little sign of a French Lady Thatcher emerging. Only Alain Madelin, of the Liberal Democrats, currently speaks a Thatcherite language of free markets and a minimalist state, and he won a mere 3.9% of the vote on April 21st.

All this puts a different perspective on the labour-market “success” of the Jospin term. True, unemployment fell from the 12.2% of the workforce inherited from the right in 1997, but only to 9%, getting on for twice as much as in Britain or America—at a time when the economy was booming and employers had jobs they could not fill. The economists concluded that 9%, or a smidgen less, was—and is—France's “structural” rate of unemployment, which can be reduced only by changing the make-up of the economy.



Go to the lovely Place du Capitole in Toulouse, or ride the subway system in Lyons, or watch a game of street-soccer in a Marseilles housing estate, and the economic jargon translates into bored young men whiling away their days doing nothing in particular: no wonder many of them trade drugs to supplement their meagre state benefits. People over 25 receive the RMI (*revenu minimum d'insertion*), created in 1988 to provide a “minimum income for inclusion in society”. For a single man with no dependants, this amounts to *euro*406 ($405) a month. In a land of plenty, some 1m of France's 24m households rely on the income of the country's 2.2m *eremistes*.

That is a waste of young energy and talent; but a similar waste goes on at the other end of the age range too. In Antibes, a town on the Côte d'Azur sandwiched between Cannes and Nice, men in their 50s and 60s go down to the seafront each afternoon to play *boules*, as do thousands of other perfectly healthy contemporaries throughout the country (albeit perhaps in less pleasant surroundings). In most other industrialised countries, they would still be toiling at the office desk or on the factory floor; in France, they are enjoying a comfortable retirement.

In other words, France's unemployment rate, already bad enough by international standards, is even worse than it looks. In Switzerland, more than 70% of the 55-64 age group are in the labour market; in Japan two-thirds; and in Britain just over half. The average for the OECD group of rich countries is 51%. But in France the share is a mere 37%.

So what, you might say with a Gallic shrug. One of France's many attractive features is that its people work to live, not the other way round (which is what critics say is wrong with the Anglo-Saxon model). Patrick Artus, the chief economist of the Caisse de Dépôts et Consignations, a venerable state-owned bank, makes a joke of it: “No one wants to increase the [labour-market] participation rate except economists over the age of 55.”

As the Pisani-Ferry report notes: “Inactivity was viewed in France for many years as an alternative to unemployment.” In other words, the government encouraged mothers to stay at home and workers over 50 to retire. This was particularly true for the Mitterrand era of the 1980s and early 90s: legislation to protect workers' rights and the proliferation of payroll charges created an exceptionally illiquid labour market. As a result, *les trentes glorieuses* (the 30 years from 1945 to 1975 when the economy boomed and jobs were there for the taking) were followed by a quarter-century in which high unemployment, especially among the young, became part of the economic landscape.

Embracing business

Could the Raffarin government begin to turn things round? Not in the short term, but at least Mr Raffarin and his team have understood a vital precondition: it is business that must create the jobs of the future, not government. The daily *Le Figaro* went to the trouble of analysing the words used by Mr Raffarin in a recent television programme about his future plans, and found that the second most frequent subject on his lips was “*entreprise*” (business)—surpassed only by the word “France”. Compared with Mr Jospin, who spent little time with business bosses during his five-year tenure, Mr Raffarin's interest in *entreprise* seems promising. On the other hand, words are not the same as deeds. For all its alleged antipathy to business, the Jospin government privatised far more of French industry than its centre-right predecessors had done. Mr Raffarin will have to show that he can do better than Mr Jospin.

In part, this will involve more privatisation. Amazingly, there are still around 1,500 companies—compared with 3,500 in 1986—in which the state has a controlling share. In theory, most of the icons of French industry are up for grabs—France Telecom, Air France and even the hitherto sacrosanct Electricité de France (EDF) and Gaz de France (GDF). But at least three things could get in the way.

One is a disinclination on the part of the government to let key industries such as electricity escape from its control, which means that in practice only minority stakes will be sold; a second is union opposition to any loss of pension and other privileges if control goes to the private sector; and the third is the abysmal state of the stockmarket. Air France, 54% owned by the state, may—when market conditions eventually suit the government—be a safe enough bet to fly further into private ownership; France Telecom, 55.5% owned by the state, risks a flop thanks to its debt of around *euro*70 billion.

But the main challenge for Mr Raffarin goes far beyond selling the family silver: it involves lightening the government's hold on the economy in general and the private sector in particular. Government spending accounts for over 53% of GDP, way above the OECD average of 38%. A steeply progressive system of income tax, for example, can claim as much as 60% of an individual's pay-packet, and even the moderately rich have to pay a wealth tax. Virtually every French citizen gripes about taxes or social charges. Admittedly, because of various exemptions, only half of all wage-earners have to pay income tax; the trouble is that the non-paying half are still subject to a variety of payroll charges that make no allowances for income differentials. Value-added tax, levied at 19.6%, also has to be paid by rich and poor alike.

Taxes on business were reduced by the Jospin government, but employers complain that heavy payroll charges still make it hard for them to compete internationally. Medef has calculated that the Jospin

government's measures, if they had been fully implemented by their 2003 deadline (in fact some changes will be made), would still have left France bottom out of 14 EU countries. For example, for every *euro*100 an employee takes home, a French employer would still have had to shell out *euro*288, compared with *euro*227 for a German boss and *euro*166 for a British one. Only a Belgian employer would pay more.

Individual taxpayers who are rich and mobile enough vote with their feet. For instance, Laetitia Casta, a model whose face now graces the country's stamps as the national figurehead, Marianne, lives for the most part outside the country; so do virtually all of the French soccer team who won the World Cup for France in 1998 (and lost it so ingloriously in 2002). It is said that up to 300,000 French people now live in south-east England, where the taxes are lower. There is clear evidence that fewer foreigners want to set up business in France, and more French people want to shift their investment abroad.

The government seems to have accepted the need to act. During his election campaign, President Chirac promised to cut income tax by 5% this year and by 30% over his five-year term; to reduce bureaucracy; and to create a million new businesses. Last month Mr Raffarin and his minister for small and medium-sized businesses, Renaud Dutreil, announced that from next autumn the charge for setting up a limited-liability company will be cut from *euro*7,500 to just *euro*1; the company will be able to operate from the entrepreneur's home for up to five years, instead of two (which still raises the question why this kind of restriction should be imposed at all); the tax-exemption limit for capital gains will rise by a third or more; and payment of the first year's social charges can be spread over five years.

French entrepreneurs will be grateful for any lightening of their load. Two years ago the OECD found that France had more business red tape than any other member, and more barriers to entrepreneurs than all but Italy. For example, simply to register a company could take four months.

Let 1m flowers bloom

Will Mr Dutreil's measures meet Mr Chirac's target for 1m new businesses by the next election? At present more than 170,000 companies are created each year, so another 30,000 a year does not look out of the question. It is not as though the country lacked talent and initiative: the Côte d'Azur science park of Sophia-Antipolis is full of high-technology start-ups and foreign investment.

The question is whether France wants that business badly enough. Back in 1925, an American president, Calvin Coolidge, famously declared: “The chief business of the American people is business.” It is hard to imagine a French politician ever embracing that sentiment on behalf of his countrymen. In an opinion poll last year, 56% of the respondents said their idea of France was “a country of solidarity and social justice”.

They are deluding themselves. According to Timothy Smith, a Canadian historian who specialises in French social policy, “a truly solidaristic society is one which pays the price for its solidarity in the here and now, instead of leaving the bill for future generations, instead of taking raises and an extra month of paid vacation (which is the consequence of the shift from the 39-hour to the 35-hour week) or an expensive pension at 55 years of age, on the backs of 2m-3m unemployed people—most of them under the age of 40.” But in France that sort of solidarity still seems a long way off.

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Tarnished glory

Nov 14th 2002
From The Economist print edition

The scandals are legion—but who cares?

THE president is suspected of misusing taxpayers' money for political gain and personal enjoyment; Roland Dumas, the former head of the nation's highest court, is appealing against a jail sentence for accepting bribes; Jean-Claude Trichet, the governor of the central bank, is facing trial for alleged connivance in a banking irregularity; and, until Mr Jospin stopped the practice last year, envelopes stuffed with banknotes were regularly—and legally—doled out to ministers and their teams, from senior advisers down to chauffeurs, to supplement their salaries.

In the past decade well over 500 politicians and businessmen have been variously investigated or convicted for corruption, and it is only the constitutional immunity granted to an incumbent president that has protected Jacques Chirac from the judges' inquiries over his activities while he was mayor of Paris between 1977 and 1995. Transparency International, a Berlin-based organisation that campaigns against corruption, ranks France 25th in descending order of perceived ethical cleanliness, equal with Portugal and behind all other EU countries except Italy and Greece.

Yet the country may well be getting cleaner. *Les affaires*, as the scandals are known, mostly relate to illegal money-raising for political parties in the 1980s and early 1990s, before a succession of laws banned corporate donations and introduced state financing. Some are linked to the late François Mitterrand, who as president from 1981 to 1995 used the state oil company, Elf, as a slush fund to lubricate foreign policy and fill friends' pockets. Others arise from the powers of the purse given to ill-paid local politicians in the early 1980s. Indeed, the very fact that the scandals have come to light suggests that there may be fewer in future. Investigating judges now refuse to bow to political pressure; the EU's single market is breaking down the barriers of corporate secrecy; and foreign investors, who own 40% of the shares traded on the French stock exchange, expect rules to be obeyed rather than bent.

Oddly, for the voters corruption appears to be a non-issue. The popularity ratings of Mr Chirac (who, with a word borrowed from the poet Rimbaud, dismisses the allegations against him as "*abracadabrantesque*") have hardly suffered; and other politicians stained by scandal have even watched their popularity rise. In September, Patrick Balkany was overwhelmingly re-elected mayor by the voters of his Paris suburb of Levallois-Perret, despite having been sentenced in 1996 to a suspended jail sentence for corruption.

Why does no one seem to care? One explanation suggests that the idea of a state based on the rule of law is just an Anglo-Saxon obsession. In France the revolution of 1789 gave power to the people. Quite naturally, the elite who rule in the people's name feel above the law.

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To have and to hold

Nov 14th 2002
From The Economist print edition

The French have been spoiled by lavish state pensions and health care. No wonder they are fighting cutbacks

THE French, as foreigners often note with amusement or irritation, have an extraordinary propensity to take to the streets. Last year there were 10,050 officially sanctioned demonstrations in Paris alone. Of these, 7,458 had a festive cause, some 331 were connected with celebrity visits and another 800 were purely political in nature. That left 1,461 demonstrations for better pay, better working conditions or job security. At times, scarcely a day seems to go by in Paris without the riot police barricading the ministerial district against putative invasions of banner-waving workers (most of them remarkably good-natured).

Reuters

Another day, another demo

Foreigners assume, therefore, that France's trade unions must be strong. In fact, in terms of numbers they are weak. In the private sector a mere 8% of the workforce are union members; in the public sector the share is around 26%. For comparison, in America union membership is 9% in the private sector and 37% among government employees.

The oddity is that France's unions are politically and socially powerful despite their numerical weakness. One reason is that they have a secure place in positions of power: in the welfare state reconstructed after the second world war, they are joint managers with the employers of the country's health, retirement and social-security organisations; they dominate company employee committees; and they are part of every labour tribunal. But the more important reason is that public-sector employees in France represent just over a quarter of the nation's workforce, a bigger share than in any other rich democracy except Denmark, Finland and Sweden. In other words, the unions negotiating on public-sector workers' behalf are a force to be reckoned with—and what the unions want as a minimum is to preserve what their members already have.

So whenever a government starts talking of reform, the unions call for demonstrations to safeguard their members' right to retire early and play *boules* in the afternoon, or whatever. And who can blame the employees for heeding that call? They have a lot to lose. Whereas workers in the private sector have to labour for 40 years before retiring on full pension at 60, public-sector workers need only 37.5 years of contributions. Moreover, following a reform in 1993, from 2008 the pensions of private-sector workers will be based on their pay in their best 25 years (compared with their best 19 years at present), whereas the pensions of public-sector workers are based on their pay in their final six months.

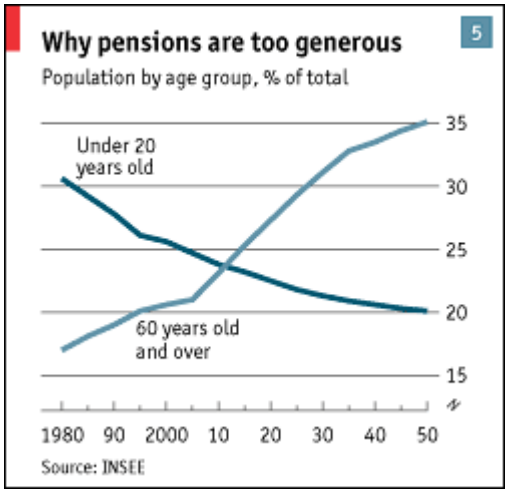
This means that a pen-pusher working for state-owned Electricité de France has a much cushier

retirement in prospect than his or her equivalent working, say, for a small printing company in Lille. And if the public-sector job includes an element of danger, the regime is even kinder: a train driver, for example, can retire with full benefits as early as 50.

Too good to last

This system provides France's pensioners with a munificent standard of living, averaging 97% of that of the working population. Unfortunately it is demographically unsustainable. Being a pay-as-you-go system, it relies on today's workers to pay for today's pensions. In French this process is called *répartition*, and in Mr Jospin's words, "*Répartition* is the symbol of the chain of solidarity that links the generations. It is one of the most important terms in the nation's social pact."

Indeed; but if the demographers are right, the share of the population aged over 60 will rise from a fifth today to a third by 2040 (see chart 5). So instead of two workers today providing the money for one pensioner, there will be only one. This points to some hard choices: either workers will have to pay higher contributions, or the retired will have to accept lower pensions, or the retirement age will have to be raised. None of these is politically palatable, and the first, in a competitive world, might turn out to be economically dubious. Just to add to the political problem, pensioners will soon start grumbling even if there are no changes to their pension rights. This is because under the 1993 reform their pensions are now indexed to prices rather than wages, which will make the retired progressively poorer relative to the working population.



Mr Jospin ducked the problem with the aid of a time-honoured device: he appointed a committee to study the problem. In the meantime, the state-owned companies would make extra contributions into a special pension reserve fund. Besides, the Jospin line ran, thanks to rapid economic growth the problem was less pressing than the pessimists claimed. What was fundamental was the principle of *répartition*: there would be no pension funds "on the model of certain Anglo-Saxon countries—that is not our approach."

President Chirac has said, somewhat cryptically, that there will be pension funds, but pension funds *à la française*. What that means remains to be seen. In practice, *à la française* may turn out to be much the same as *à l'américaine*. Despite Mr Jospin's rhetoric, his government presided over the introduction of company-managed savings schemes in which workers invest in mutual funds and equities—rather like workers in America with their 401K plans. The problem is that the Anglo-Saxon way looks less attractive with every fall in the stockmarket.

Poor Mr Raffarin, who has promised to pronounce on pension reform in the spring, is bound to make himself unpopular whatever he does. The demographic pressure could certainly be lightened by bringing more women, young and older people into the workforce—but that would require the introduction of employer-friendly measures which would upset the unions and the left. Raising the retirement age and increasing contributions will be similarly unpopular. Even privatisation—one way to find money for pensions—will be fraught with difficulty, because state companies such as Electricité de France and Gaz de France have unfunded pensions obligations that private shareholders will be unwilling to take on.

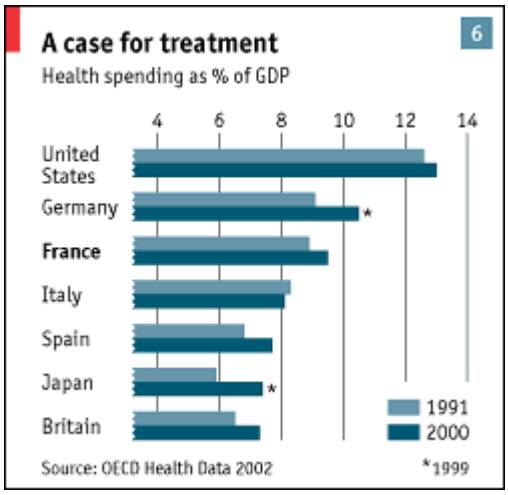
Elie Cohen, an economist at Sciences-Po and an adviser to several past governments, believes that the deteriorating arithmetic will require action on pensions to be taken within the present government's five-year term. Possibly so, but resolving the arithmetic on other state commitments may be even more urgent.

Remedial action

By any measure, France's health service is among the best in the world. Life expectancy for women (despite a collective reluctance to stop smoking) is second only to Japan, and the men are not far behind (despite, or because of, a continuing love of wine). There are no waiting lists for hospital treatment; general practitioners are prepared to make home visits, even at night and during the weekend; and the poor get their treatment free. For the rest of the population, the cost is almost, or entirely, covered by a

combination of the state's social-security system and co-operative insurance bodies known as *mutuelles*. Not surprisingly, the French visit their doctors at the first sniff of a cold, go into hospital more often than others, and swallow more pills than anyone except the Japanese.

Unfortunately, all of this comes at a price that threatens to grow inexorably with increasing life expectancy and the expensive medicines and technology that go with it. France spends almost 10% of its GDP on health, a little less than Switzerland and Germany (see chart 6). For comparison, Britain spends a frugal 7% and America an extravagant 13%. Looking at the life-expectancy rankings, you might conclude that the Americans are wasting their money—and perhaps that the French are too, because those frugal Britons, for all their ghastly hospital waiting lists, live almost as long as their neighbours across the Channel.



French governments have been worrying about lavish health spending for decades. Back in 1978 the centre-right prime minister of the day, Raymond Barre, raised social-security contributions and cut hospital spending. But when he also tried to penalise over-prescription, the doctors defeated him with a series of strikes. In the mid-1990s, Alain Juppé was similarly frustrated by the doctors, but at least he wrested away the task of setting the annual target for social-security spending from the joint body of unions and bosses. Instead, it was handed to parliament. Thanks to this innovation, over the years the social-security deficit was first checked and then turned into surplus in the three years from 1999.

But only two months ago the Cour des Comptes, which audits state spending, released a report to the effect that the 2001 surplus was hiding a “fragile situation”—so fragile, in fact, that this year the social-security system will lapse into a deficit of *euro*3.3 billion ($3.3 billion), due to increase to *euro*4.6 billion next year. One reason is the slowdown in economic growth, and the tax receipts that go with it; a second, however, is that health spending—which accounts for two-fifths of the social-security budget—keeps exceeding the limits set by parliament. For example, the limit for 2001 was set at *euro*106 billion, but the amount actually spent was *euro*109 billion.

This was the fourth, and worst, consecutive year of excess spending, prompting the state auditors to comment: “The contradiction is ever stronger between the desire to set objectives and the inability to put in place the means to regulate them.” The auditors reckon that too many French hospitals are in the wrong place, or offer wastefully overlapping services; that there are 30,000 surplus beds across the country; that drugs are prescribed too often and too expensively; and that a quarter of those who call on the emergency services have no urgent need at all.

But will the politicians pluck up the courage to reform the system? The signals are mixed. Almost as soon as it came to power, the Raffarin government caved in to a series of strikes by France's 55,000 family doctors that had started under its predecessor. The doctors won an 8% increase to *euro*20 for a consultation and a 46% rise to *euro*30 for a home visit. Well deserved, thought their patients, for a profession where the average annual salary, after expenses, is a moderate *euro*51,000—but the award adds another *euro*1.2 billion to the social-security bill.

EPA

Indispensable

In theory, the health ministry intends to claw back all this and more by raising tobacco taxes; by requiring half of all prescriptions to be for generic drugs (much cheaper than those under patent); by paying for other, brand-name drugs as though they were generics; and by refusing to pay for 835 medications judged to be useless by the country's independent food and health safety agency.

Ominously, however, the Socialist Party and the unions are already criticising this supposed erosion of the medical sector's freedom of action. The unions complain, too, that the introduction of the 35-hour week, combined with the government's reluctance to hire more workers for the public sector, is placing an unfair burden on their members.

Reform needs courage

If all that suggests trouble to come, so does the commitment to slim the civil service. For example, it is clearly a nonsense that the Ministry of Finance, with almost 180,000 employees, has two separate organisations to deal with taxes: one to assess them, the other to collect them. Similarly, with the baby-boom long over, it is hard to see why the education ministry needs more than 960,000 employees; hard, too, to justify a junior defence minister, complete with his own department, for the dwindling number of veterans of France's wars. One explanation is that politicians may be more sympathetic than they should be—after all, two-fifths of the members of the National Assembly are on leave from the civil service.

But the leverage of the civil service stretches far beyond that. By one calculation, 57% of the adult population are either civil servants themselves, or are children, parents or spouses of civil servants. Ministers naive enough to attempt reform tend to lose their jobs—witness, in the Jospin government, the education minister, Claude Allègre, and a short-tenured finance minister, Christian Sautter. When a junior education minister in the present government pointed out that some 3,000 jobs could be saved because there were now fewer schoolchildren needing to be taught, his boss had to calm the storm by explaining that the lost jobs would not be teaching ones.

The temptation, therefore, is to let matters rest. After all, almost half of the civil service will be retiring in the next decade, and not all of them will be replaced. So perhaps, say the optimists, the fat can be cut painlessly. But meanwhile, thanks to Mr Chirac's pledge to boost internal and external security, next year the ministries of the interior, justice and defence will all have more employees rather than fewer. Indeed, for all the talk of reducing numbers, next year's total tally of civil servants in central government, including 459,000 in defence, will be 2,180,240—a mere 1,745 fewer than this year.

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The French exception

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From The Economist print edition

From agriculture to Europe, France gets away with doing its own thing

AP

Tons of joie de vivre

THE vineyards bake in the sun of Provence; vast cornfields stretch golden across the plains of Picardy; in Brittany the cattle slowly munch their way from one deep green field to another; in the Dordogne the geese are having their livers fattened for the world's best foie gras. All this is *la France profonde*, that entrancing country of picturesque villages and revered cuisine. No wonder France is by far the world's most popular tourist destination for foreigners. And no wonder the French themselves, not least President Chirac, are determined to preserve it.

Yet the pastoral idyll is in part a myth. The country towns are surrounded by hypermarkets and car-lots; the villages have garish kiosks dispensing videos; and, all too often, the fields and rivers are polluted with pesticides. Meanwhile, the true *paysans* (the word translates better as "country folk" rather than "peasants") are dwindling in number: down to 627,000 in the 1999 census, a drop of 38% on ten years earlier. Their place has been taken by the modern barons of industrialised agriculture (the average farm now is half as large again as in 1988); or the workers who commute to the nearest town; or the Parisians and foreigners who have bought second homes in the country.

Rus in urbe

So why is the myth so important? The answer is a mix of nostalgia, culture and economic self-interest. Only two generations ago, agriculture accounted for one-third of the nation's workforce, which explains why even the most confirmed city types usually still have some rural connection. Mr Chirac once said: "The farmers are the gardeners of our country and the guardians of our memory." But there is rather more to it than gardening: helped by an EU Common Agricultural Policy designed with French farmers in mind, France has become the world's fourth-biggest producer of cereals and meat and pockets a quarter of the CAP's funds.

That does not please José Bové, the pipe-smoking, moustachioed leader of the Confédération Paysanne. Mr Bové, a former student activist turned occasional goat-cheese maker, is demanding a more literal interpretation of the myth. He has become a popular hero by attacking globalisation and the CAP for industrialising agriculture at the expense of the small farmer. Two years ago, when he appeared in court for trashing the site for a new McDonalds restaurant, 30,000 demonstrators gathered in his support. He was briefly imprisoned earlier this year.

By contrast, the politicians think the myth is best served by holding on to the status quo. When the European Commission earlier this year proposed replacing production subsidies for farmers with direct payments geared to their care for the environment, Hervé Gaymard, France's agriculture minister, led the counter-attack. Gathering the signatures of six other EU agriculture ministers, Mr Gaymard sent a letter to several European newspapers, noting: "For us, agricultural products are more than marketable goods; they are the fruit of a love of an occupation and of the land, which has been developed over many generations...For us, farmers must not become the 'variable adjustment' of a dehumanised and standardised world."

Cri de coeur or hypocritical power politics? Perhaps a bit of both. Mr Gaymard's argument is that the CAP has served Europe well, and that its reform should not be rushed, but should involve a debate going back to first principles. Then again, the letter was published on September 24th, to coincide with a meeting of

agriculture ministers in Brussels. Moreover, it guaranteed a French victory: the signatories represented a minority big enough to defeat not just the commission's plans but also the wish of several northern countries, particularly Britain, to renegotiate the CAP before the present agreement on the EU's finances expires at the end of 2006.

What kind of Europe?

All this, say the critics, is proof that France, a founder member of the EU, sees it only as a vehicle for its own national interests. But that hardly seems a damning verdict. After all, why join a club if it does not serve your interests? For France, the European club has always served two purposes: to ensure peace with Germany after three wars within a century; and to provide a counterweight to America's power.

Still, the French seem to have a way of bending the club rules to their advantage. For example, back in 1965, when the France of President De Gaulle boycotted Europe's institutions for six months, its “empty chair” policy successfully checked Europe's supranational course, guaranteeing each nation the right to a veto if its vital interests were at stake. And in the early 1990s France held the Uruguay Round of trade negotiations hostage until it won the right to a “cultural exception”, allowing it, in effect, to subsidise French films and discriminate against American ones.

In the same vein, Mr Raffarin's finance minister, Francis Mer, blithely told his EU colleagues last June that their “Stability and Growth Pact”, a 1997 accord under which all countries had pledged to balance their public-sector budgets by 2004, was “not set in stone.” The commission and the other EU members agreed, giving France until 2006 to meet the deadline. But the medium-term budget plans which Mr Mer announced in September show that France will still have a 1% deficit in 2006, prompting open criticism by the commission. Mr Mer seemed unfazed. After a meeting with his EU counterparts last month, he declared: “We decided there were other priorities for France—for instance, increased military spending. Other countries have not taken this kind of decision, but we are still in a Europe where budgetary policy and political decisions are under national control.”

It sounds rather like a Europe in which France remains an independent nation-state, choosing for itself when and how to co-operate with the rest of the club. That is one reason why the tie with Gerhard Schröder's federalist-minded Germany has come under strain. However, the tie still holds: last month in Brussels, Mr Chirac, outmanoeuvring—and enraging—Britain's prime minister, Tony Blair, persuaded Mr Schröder that the CAP should remain unchanged until 2006.

Back home, François Bayrou, leader of the Union for French Democracy and a member of the European Parliament, is one of very few French politicians to share the Belgian, Italian or German vision of a powerfully supranational EU. Other visions for the future of the EU, from a confederation of nation-states to a “hard core” of “the willing and the able”, all have one thing in common: in essence, France will retain its freedom of action and Europe will serve France's purpose. How else could De Gaulle and his political descendants, including Mr Chirac, have accepted the notion of a communal Europe? Nor are such attitudes confined to Gaullists: the Socialists' François Mitterrand may have talked of “the European project” and “the European construction”, but in his alliance with Germany's Chancellor Kohl he preserved France's role as the architect.

Quite contrary

The same streak of Gaullist independence is evident in the way France so often disagrees in public with the United States, in particular over the Middle East. The most obvious example is the squabbling over what kind of UN resolution to use against Iraq, but there are plenty of others. When President Bush linked Iraq, Iran and North Korea in an “axis of evil”, the Socialist foreign minister of the day described the American approach as “simplistic”—the same adjective Mr Raffarin now uses for America's policy.

All this is fine for France's *classe politique*, trained to deal with the intellectual contortions of being an insider in the rich world's councils yet an outside critic at the same time. Earlier this year, for example, both the Jospin government and the opposition sent representatives to the World Economic Forum in New York—but also sent twice as many to the rival, anti-globalisation summit in Porto Alegre, Brazil.

But what of those lesser mortals who make up the electorate? For them it smacks of double-talk. No wonder so many, either by abstaining or by casting a protest vote, took their revenge in the presidential

election last spring. They felt lost, and the elite had not bothered to show them the way.

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High and mighty

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France's elite is too clever by half

ALL nations—even those who once believed in Marx—have their elites, so why should France be any different? Philippe Méchet, a well-known opinion pollster, jokes: “We're a very royalist country, and we killed the king. So now we've monarchised the republic.”

You can see his point. The American president lives in the White House, but the French president lives in the Elysée Palace, a choice of noun that conjures up a whole retinue of courtiers and uniformed flunkies. Indeed, when the Socialist François Mitterrand inhabited the Elysée, he lavished so much public money on grand schemes for the capital and its monuments that he was often compared to Louis XIV, the “Sun King”.

Take the analogy a touch further and you have a modern nobility, products of the *grandes écoles*, a handful of universities—such as Sciences-Po in Paris or the Polytechnique just south of the capital—that are acknowledged to be centres of excellence. In particular, you have the *énarques*, graduates of the Ecole Nationale d'Administration (ENA), a postgraduate school established by De Gaulle in 1945 to train a civil service untarnished by the Vichy regime's collaboration with the Nazis.

It has long been fashionable, even among *énarques*, to criticise ENA as being too elitist for the national good. Recruiting through fiercely competitive written and oral exams, the school has an intake of just 120 students a year for its 27-month-long curriculum. Multiply that by the number of years since ENA was established, allow for some natural wastage, and you get a total figure for living *énarques* of perhaps 5,000.

Monarchs of all they survey

That elite, minuscule compared with the massed alumni of Britain's Oxbridge or America's Ivy League, commands most of what matters in France. Mr Chirac is an *énarque*, as is Mr Jospin (but not Mr Raffarin); so too the head of the employers' association, Ernest-Antoine Seillière, and many of the bosses of leading banks and businesses, from Jean Peyrelevade of Crédit Lyonnais to Jean-Cyril Spinetta of Air France.

Is this a good or a bad thing? It depends how you look at it. As one *énarque* at the finance ministry says scathingly, “*Enarques* are pretty smart individually, and pretty dumb collectively.” ENA's graduates can hardly help being clever: the meritocratic recruitment process is designed to draw bright children from humble backgrounds into the elite (one example is Hervé Gaymard, the agriculture minister). They are also competent: having been groomed for the task of administering the state, by and large they make a good job of it.

The reason that they can be “collectively dumb” is that they all come from the same educational mould, which makes their responses somewhat predictable. Their civil-service instinct is to mistrust the private sector and private initiative. Given their predominance in so many key posts, they have been criticised for holding back France's energy and creativity. But perhaps the dumbest thing they do is to ignore the views of lesser mortals, and assume that they always know best.

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A magic moment

Nov 14th 2002
From The Economist print edition

President Chirac has five years in which to reform France

THE French body politic has had quite a momentous year, but the sense of shock is now fading. The new obsession of the chattering classes is Iraq and American foreign policy (which has catapulted two thoughtful books on French anti-Americanism into the bestseller list). For the political right, the obsession is unity: let the rival parties that coalesced into the Union for the Presidential Majority become a single vehicle to elect the next president in 2007 (Mr Juppé, or Mr Sarkozy, or—some now whisper—Mr Chirac again?). For the opposition, so much in retreat that the Communist Party, once the largest party of the left, is now struggling to survive with just 21 supporters in the National Assembly, the task is not so much to bind its wounds, but to fight it out until the would-be modernisers of the Socialist Party, such as Dominique Strauss-Kahn and Laurent Fabius, either win or lose.

The government, for its part, talks of “decentralisation”. Patrick Devedjian, the “minister of local freedoms”, argues that it is time to give power to local officials and to get away from the Napoleonic military logic of a “chain of command” that always leads to Paris. In that way, perhaps a solution could at last be found for Corsica, whose bomb-planting extremists are bent on secession.

But does any of this indicate that the country is facing up to its problems? Sadly, not enough. The *fracture sociale*—a campaign slogan of Jacques Chirac's in his first bid for the presidency, in 1995—still divides the nation; the elites still pontificate at an arrogant distance from *la France d'en bas*; necessary economic reforms still remain a matter of talk rather than achievement; and policy is all too often a consequence of confrontation rather than negotiation. Worst of all, perhaps, is the temptation to seek refuge in a false comfort zone: France as an independent nuclear power, as a permanent member of the UN Security Council, as a member of the G8 club of economic powers—and, of course, as a country that takes culture seriously. France may not match the Anglo-Saxons for Nobel laureates in economics, but in literature it comes top.

Yet there is no need for such a comfort zone. France's engineers are among the best in the world—witness not just high-technology triumphs such as the Ariane rocket programme or the TGV railway system, but also lower-technology successes such as Michelin tyres or the cars of Citroën and Renault (a good enough company to take over Japan's Nissan and return it to profit). The same is true of some of its bankers, insurers and retailers, who successfully compete on the world stage. AXA, for example, will insure your life in America; Carrefour will sell you groceries whether you live in China or Chile.

The disappointment is that such assets are undervalued in the public mind, especially since the fall from grace of Jean-Marie Messier (a graduate both of ENA and the Polytechnique), with his improbable dream of turning a sewage and water company into the Vivendi Universal media giant. Denis Ranque, the boss of Thalès, a French defence and electronics group operating in more than 30 countries, has an explanation: “Popular knowledge of the economy is weak in France. We have important industries, but the French don't like them. They associate them with pollution, not jobs.”

Elie Cohen, the economist at Sciences-Po, argues that France has been an ordinary market economy since the mid-1980s, when the folly of Mitterrand's nationalisation programme of 1981-82 became obvious even to the president, but: “The spirit of Gallo-capitalism remains. Each time there's a problem, you appeal to the state.” Yet surely an “ordinary” market economy would not go to the lengths France does to resist the liberalising demands of the EU, in particular in the energy market, where EDF is protected at home even as it creates an empire abroad.

Face up to reality

No matter, you might say: France has prospered regardless. Indeed, there is a certain pragmatism

behind the rhetoric: criticise globalisation but profit from it too; criticise America but support it at the same time. The problem is that sooner or later this form of self-deception could turn into self-destruction. In 1995, it prevented France's government from getting the popular backing to carry out reforms that have now become all the more necessary.

During his first presidential term, Jacques Chirac's critics had a common taunt: he was a man who knew how to win power, but not how to wield it. But there was a reason: from 1995 he was locked by the voters into cohabitation with his political opponents. For the next five years, he has no such excuse: having promised to reform France, he now has the power to do so. May he use it wisely.

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America's car industry

Storm clouds over Detroit

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AP

Things look bleak for America's motor industry

CAR sales in America plunged in October, compared with the same month a year earlier. To some degree, this was inevitable: October 2001 was an artificial peak caused by General Motors' introduction of “0% finance” (ie, interest-free loans) to keep sales moving after September 11th. Yet, after a decade of climbing from 13m vehicles a year to 17m, sales now seem set for a long slump. Some analysts think they will fall by as much as 10%, especially if the economy dips back into recession. This is particularly bad news for America's so-called “big three”, which are in worse shape than many foreign rivals. Detroit has mixed losses and lousy profits even in the boom. Merely a small dip in sales can hit a car maker's bottom line very hard.

The GM scheme kicked off a credit binge, as other firms followed with every sort of carrot to tempt consumers, from discounts and zero interest rates to delayed repayments and no deposits. Initially, the impact was expected to be brief. Even Rick Wagoner, GM's boss, doubted that the boom would last much into this year, as some sales would simply be buyers bringing forward their planned purchases.

But incentives are addictive, as Lee Iacocca, a former boss of Chrysler, observed in a previous crisis. Rather than let sales slow, by the summer GM, Ford and Chrysler were offering incentive deals worth $2,000-3,000 a vehicle. (European and Japanese firms have mostly had to give away less than half as much, as their brands are stronger.) Several times GM has tried to cut incentives, but each time sales slowed and it reintroduced them.

Coping with the first downturn in a decade was always going to be hard for Detroit's big car makers. Ford and Chrysler plunged into loss in recent years, even as sales boomed. This profitless prosperity drained their coffers, and drew attention to their liabilities, such as their underfunded pension and benefit promises to workers (see article). The rating agencies recently downgraded the debt of Ford and GM almost to “junk”. This makes it costlier for their finance arms to raise capital.

Big wheels don't keep turning

Worse for the big three, they no longer dominate at home. Increasingly, Toyota Camrys, Honda Accords and Volkswagen Jettas rule the roads. California and other Pacific coastal states have long preferred foreign brands (albeit now mostly made in America). Now New England, New Jersey and Florida are

going the same way.

Detroit's share of the American car market has slipped: from 73% in 1996 to barely 63% last year, according to figures in *Automotive News*. It is on course to fall below 50% within a decade, with a disproportionate chunk of those sales concentrated in the mid-west. Taking out pick-ups, sport-utility vehicles (SUVs) and minivans, the home-grown American share of the passenger-car market is already only 47%.

America is coming to resemble Europe in its balkanised car market, with a handful of firms battling it out behind a market leader (Volkswagen in Europe; GM in America). The European market, plagued by 30% overcapacity, is so tough that both Ford and GM have been losing hundreds of millions of dollars there, and Italy's Fiat is collapsing into the arms of its biggest outside shareholder, GM. Similarly hard times probably await the Americans at home. Indeed, another of the big American firms may yet need rescuing, as Chrysler did twice—in the 1970s by the government, and in the 1990s by Daimler-Benz.

Ford is finding today's market especially harsh. Last year Bill Ford, a member of the founding family (which still owns 40% of the voting shares), ousted Jacques Nasser as chief executive. On his watch, quality had slipped, morale had slumped and the firm had to write off billions after it emerged that Firestone tyres may have caused its Explorer SUVs to crash. Now, Ford's recovery plan—closing five plants, shedding 35,000 workers and hacking component costs—may be going too slowly. And new problems, such as a $500m loss at Jaguar, caused by two botched product launches, are cropping up. Yet fast turnarounds are possible in this industry. For instance, in moribund Japan, Nissan, with bigger problems than Ford's, showed signs of recovery within a year of Carlos Ghosn becoming boss.

Partly because of the power of the unions, America's car makers find it almost as hard as do their European counterparts to cut output and capacity to match changed circumstances. As productivity rises, on average, by 3% a year, compared with demand growth of 2%, there is an inbuilt tendency to develop excess capacity. Yet each firm has sunk so much capital in plants that it is strongly tempted to use the capacity to build extra cars that fetch enough revenue to cover marginal costs in the short run, but not total costs in the long run. Keeping cash flowing in and grabbing a bit more market share, as GM is doing now, makes sense for a while. But eventually, especially if sales dip, it will become clear that the producers have dug themselves a collective hole. As Mr Nasser told *The Economist* this week, Detroit's problem is that it has been “going in the wrong direction for the last 30 or 40 years. It hasn't just happened in the last 12 months.”

True, since 1990, the capacity of the big three has declined modestly, from 14m vehicles a year to 13m. But that is too little, too late. In the same period, foreign firms have doubled capacity in America from 1.9m to over 4m. By 2008, foreign-owned capacity is forecast to be 5.4m. Toyota and Nissan are building new plants, and Toyota is rumoured to be considering yet another. Hyundai, South Korea's biggest car maker, is coming, and BMW, Honda and Mercedes are all expanding existing capacity.

Most worrying of all for Detroit, much of the new capacity is aiming at the one part of the market where the big three made serious money in the 1990s. They survived then by skilfully tapping the fashion for SUVs and minivans. Their products had the field to themselves, as the Japanese and Germans were slow to move in.

As demand for these family-friendly “light trucks” rose, from a third of the total passenger-vehicle market to about half, Detroit has converted car plants to make SUVs and minivans, bringing capacity to around 6m. Even so, until recently, the plants were full and profits fat—up to $10,000 per vehicle. But now the Japanese are opening plants to build SUVs and other light trucks in America. According to Deutsche Bank, this will boost capacity by 1.7m in the next three years, just as the boom is over. With 20% overcapacity in car plants, Detroit has relied on the busy light-trucks business to earn its profits—the vehicles account for a staggering 75% of DaimlerChrysler's American output, for instance. If the investment under way means these factories too are soon only 80% utilised, Detroit will lose the lifeline that allowed it to survive the past decade. It is heading for a nasty “fender-bender”.

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Company pensions and benefits

Ticking bomb

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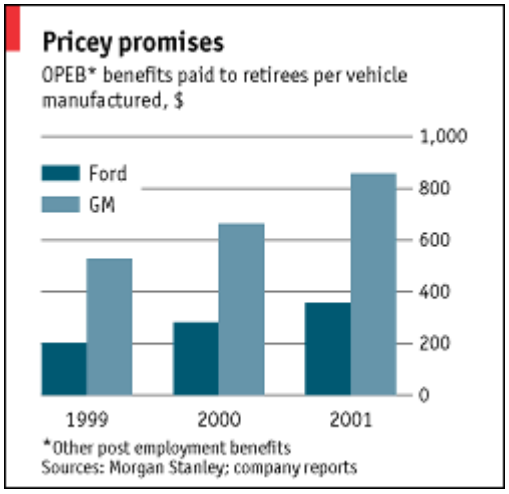
From The Economist print edition

Unfunded benefit promises to retired employees are now too big to ignore



OF ALL the troubles facing America's car makers, the worst may be their unfunded promises to workers, especially retired ones. Fitch, a rating agency, estimates that in 2002 the aggregate pension shortfall of car firms will top $30 billion, most of it attributable to Ford and General Motors. Things look worse when other post-employment benefits (OPEBs), primarily retiree health care, are added in. Last year, GM doled out a hefty $857 in OPEBs for every vehicle it built (see chart).

Car makers are not alone. Three years of paltry equity returns and low interest rates have led to an aggregate shortfall of funds compared with pension liabilities, for all firms in the S&P 500, of around $300 billion in 2002. The total doubles when OPEBs are added, as these are typically unfunded because, unlike pensions, firms get no tax breaks for setting aside assets against future liabilities. In Europe, too, pension deficits are causing waves in the Netherlands and Britain, the two European countries in which pre-funded defined-benefit pension schemes (which pay a pension related to an employee's final salary) are prevalent. Pension underfunding in Britain will reach £100 billion ($160 billion) this year, says Watson Wyatt, a consultancy.

Even an uptick in the stockmarket, not a racing certainty to say the least, may not help much. “What people are missing is how high returns have to be just to stop the underfunding problem getting worse”, says Trevor Harris of Morgan Stanley. If pension-fund returns average 6% a year in future, American firms may have to stump up another $80 billion to close the gap, calculates Goldman Sachs. At 4% a year, the figure rises to $110 billion. That would hurt profits, especially if, as is quite likely, accounting bodies introduce standards that force firms to reflect properly the impact of their pension obligations.

In October, Standard & Poor's, another rating agency, downgraded GM, citing pension deficits as a main reason. Last week, Northwest, an airline, announced a pension-related charge that could exceed $700m in the fourth quarter. It also petitioned the government to let it contribute shares in lieu of cash and to reschedule other contributions to avoid a liquidity crunch during the industry downturn. Others will follow.

Many of the hardest-hit firms are in mature industries—airlines, steel, cars—with large (and growing) retiree populations. The average ratio of active employees to retirees for GM in America is 2.3-to-one; in the steel industry it is three-to-one. Strong unions mean that simple solutions on paper—eg, trimming OPEBs—are not so simple in practice.

Can anything be done? OPEBs are easier to wriggle out from than pensions. American firms are legally obliged to make good any pension-fund shortfall of more than 10%. Other than praying for 36,000 on the Dow, bosses may feel better off not having to worry about whether their pension fund will bankrupt their business. Several British firms are considering paying insurers to take on their pension obligations, says Kevin Wesbroom of Hewitt Bacon & Woodrow, a consultancy. That would not get rid of the underfunding problem, but it might stop it getting any bigger.

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Telecoms

The wired and the wireless

Nov 14th 2002
From The Economist print edition

Should telecoms firms own a big network, or no network at all?

"WORLD domination—the same old dream," says James Bond wearily to Dr No, the villain in the film of the same name. He might have said the same thing to the bosses of the world's telecoms firms as they tried to build global networks during the boom. Their plans, like those of many a Bond villain, now lie in ruins: supply far outpaced demand. Many carriers are bust, and the rest are dealing with the after-effects of their bids for global supremacy. This week Cable & Wireless took an axe to its global division, cutting 3,500 jobs and taking a $6.5 billion charge. Deutsche Telekom was expected to announce a write-down of *euro*20 billion ($20 billion).

Amid the carnage, however, a new breed of telecoms firm is turning the discredited conventional wisdom on its head. Rather than build global networks, these "virtual-network operators" (VNOs) have taken the opposite approach: it makes more sense, they argue, not to own a network at all. Instead, they lease connections from traditional operators and stitch them together to create a virtual network.

This has many advantages, says Allen Timpany of Vanco, who pioneered the approach. Now that the notion of a single carrier with global coverage has been exposed as a fiction, multinational firms have to use several operators and stitch the networks together themselves. Ford, for example, found that it needed links from 12 separate carriers to connect offices in Europe, the Middle East and Africa. It is less fiddly to outsource to a VNO, which does the stitching, maintains close links with operators in many countries, handles procurement and consolidates billing.

Another benefit, says Francesco Caio of Netscalibur, a European VNO, is that by relying on many operators, VNOs insulate customers from the risk of a single operator going bust. His firm picked up several customers after the sudden collapse of KPNQwest, a pan-European operator, in June. Also, he suggests, VNOs can offer better service than conventional operators. "People who are good at infrastructure are not necessarily good at services," he says. "Skills matter more than owning fibre."

The emergence of VNOs is a natural consequence of competition, argues Andrew Heaney of Spectrum, a consultancy. In the old days before deregulation, the only way to get fair wholesale pricing for network connections was to own the network. But as it becomes possible to buy capacity at a fair price (or less), the case for owning the network falls away. VNOs can then be more innovative than operators that own their networks, Mr Heaney observes, because they are not committed to particular vendors or technologies.

By acting, in effect, as independent brokers of connections, VNOs can also ensure that their customers get the best deal as prices fall and new technologies emerge. Mr Timpany says his firm takes a 30% cut when it finds a way to reduce costs for its customers. "There is an incentive for us to save them money," he says. That is not true of conventional carriers hoping for a return on their infrastructure investments.

But as the VNO model takes hold, notes Mr Heaney, VNOs will face increasing competition from "systems integrators", such as IBM and EDS. These companies can incorporate network design and procurement into larger information-technology projects. "Before long, people will ask: 'Can't an IT firm do this?'," he says. VNOs risk being squeezed between conventional carriers and systems integrators. However, Mr Caio says that the three sorts of firm require very different skills. VNOs, in short, know their place; not for them the same old dream of world domination.

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HP and Compaq

Merger mystery

Nov 14th 2002 | SAN FRANCISCO
From The Economist print edition

What does the departure of Michael Capellas say about the merger?

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EPA

Carly the survivor

WHEN two big computer makers, HP and Compaq, completed their $19 billion merger in May, many believed that Carly Fiorina, chief executive of the combined firm, would be the first to go. She was considered damaged goods after the bruising proxy battle preceding the deal. But on November 11th it was Michael Capellas, Compaq's former boss and second in command at the new HP, who resigned. He is expected to take the helm at WorldCom, a bankrupt telecoms firm.

HP's shares fell by 11%, as investors worried that, without Mr Capellas's operational skills, Ms Fiorina would not be up to the job of seeing through the complex merger. Yet it was not integration pains that seem to have driven Mr Capellas's decision, but the urge to be number one—plus a severance package worth $14.4m. The bigger question is how the merged firm is doing. HP's quarterly results, due out on November 20th, could provide the first answers.

During the proxy battle, Ms Fiorina promised that the deal would not end up as another failed technology mega-merger and set out some clear milestones. Costs, she said, would be cut by $500m in the second half of fiscal 2002 and by $2.5 billion the following year. The savings appear to be on track. Procurement costs are down by an annualised $419m, three-quarters of the 2003 goal. By the end of the year, 10,000 workers will have left HP, almost two-thirds of the 16,800 planned lay-offs.

If the merger has not turned out to be a disaster, that is thanks in part to its difficult birth. The fight put up by Walter Hewlett, son of one of HP's co-founders, pushed the two firms to plan the integration extensively. Helpfully, the Internet allowed them to do such detailed planning and, later, efficiently to communicate the results to employees and customers—often a problem in mergers. And the prolonged technology recession has given the combined company enough time to implement the integration plan properly.

Yet the fact that business has not picked up as expected—and will not until next year, according to Ms Fiorina (perhaps optimistically)—makes the merger's next phase very tricky. In HP's third quarter, ending in July, revenues were down by more than 11%, mainly because of poor results in the PC business. The firm has lost its number one spot to its rival, Dell. HP remains the largest supplier of retail PCs, but its share price was also hit by speculation that Wal-Mart, the world's largest retailer, is planning a range of own-brand PCs.

The enterprise-systems group, which sells software and servers, also did badly. Only printers, which generate most of HP's profits, did better than expected. But overpriced printer cartridges will not bail out HP for ever. If it is to make the merger a real success, the firm needs to fix its other businesses, and in particular enterprise systems, says Steven Milunovich, an analyst at Merrill Lynch. In the short term, this means further cost-cutting. But in the longer run, HP's two big bets have to pay off: computer systems based on Itanium, Intel's new high-end chip, and management software to run what the firm calls Utility Data Centres.

Although Itanium has come a long way technologically, it is unlikely to take the world of corporate computing by storm. Worse, HP's rivals, IBM and Sun Microsystems, are at least as far along with their

own plans to develop software for computing “power-plants”. If HP's efforts in these two areas do not bear fruit, Ms Fiorina may have to go after all. Perhaps Mr Capellas, having turned around WorldCom, might then return as saviour.

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Vespa takes on Manhattan

Amore

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Will NY love Italian scooters?

MOTOR-SCOOTERS may be a common sight in European cities, but in America the lithe two-wheelers are something of a rarity. London boasts four times more registered motorcycles (including scooters) than New York. Only in California, where scooters made their debut in the mid-1950s, have the machines established a big following.

Piaggio USA, a subsidiary of Fiat, has just opened a “Vespa boutique” in lower Manhattan, the 57th to open since the marque was relaunched in America two years ago. Each store plugs the “Vespa lifestyle”, proffering designer bike-wear, branded accessories and sometimes cappuccinos—oh, and scooters—in an atmosphere of Italian cool. It is a far cry from Vespa's utilitarian roots, but it seems to work: Giancarlo Fantappie, Piaggio USA's boss, says sales of Vespas have grown from 64 a month in early 2001 to around 1,000 now.

Inadvertently, the European Union played a part in the resurgence. A move to tighten controls on emissions sent Piaggio's designers scrambling to their drawing-boards in the early 1990s. Some $230m later, they emerged with a revolutionary four-stroke scooter engine capable of meeting not only EU laws but also American ones. It was the tightening of emissions controls, particularly in California, that forced Piaggio to stop selling the old, two-stroke Vespas in the American market in the early 1980s.

The discovery of two dozen shops in America dedicated to restoring and glorifying antique Vespas was a factor in the decision to relaunch. Today's buyers include not only college-bound youngsters, attracted by the scooter's retro cool and its ability to zip about campus, but a wider population too. Celebrity owners—from up-and-coming rappers to Hollywood stars, such as Robert De Niro and Sarah Jessica Parker—have given the Vespa wider aspirational appeal.

New Yorkers already drive as scarily as a typical Italian Vespa rider. But will they look as cool when they bump along the city's mean, pot-holed streets?

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Privatisation in Eastern Europe

Closed shop

Nov 14th 2002
From The Economist print edition

Nationalists are stirring up a revolt against foreign investors

PITY Wieslaw Kaczmarek, Poland's embattled treasury minister. Having been criticised by the OECD and the IMF for stalling privatisation, he is now being hauled over the coals in parliament for selling off the family silver. Nationalist MPs turned last month's sale of Stoen, Warsaw's power utility, to Germany's RWE into a political cause célèbre, emboldened by a new opinion poll showing that 87% of Poles want their biggest firms to remain in state hands.

Poland has gained mightily from foreign direct investment, from the retail business, where western hypermarket chains offer well-stocked shelves and massive choice, to banking, where international lenders are helping to improve risk management. So the hostility is somewhat puzzling. But it was clear from the arguments deployed by opponents of the Stoen sale—which ranged from the unabashedly demagogic to legitimate questioning of the government's strategy for privatising electricity—that Poles are now infected with a wariness about foreign investment that is spreading across Eastern Europe.

Gone are the days of speedy sell-offs. Whether it reflects “small country syndrome”, the yearning to build national champions or concerns over the appropriate level of foreign ownership in some areas, economic nationalism is on the rise. With few locally controlled companies left with the wherewithal to stand up to the multinationals, there is political pressure to keep the crown jewels out of the clutches of western giants. (Assuming there is much left to privatise, which there is not in some more advanced post-communist economies, such as Hungary's.)

In some ways this is not surprising, given the lengths to which many west European governments go to shield their own domestic markets from outside competition. This protectionism inside the EU is often brought up by Poland's government, which plans to keep control of a big retail bank, PKO BP, ostensibly to help support Poland's cherished small and medium-sized enterprises. Poland has also put three large power plants that are in the process of merging off limits to foreign strategic investors. “It's our last chance to create a Polish group that can compete in a fully liberalised market,” insists Mr Kaczmarek.

Yet can these countries afford not to privatise? With scant financial and administrative resources, east European governments are ill-equipped to restructure ailing industries. An infusion of private investment is crucial. Floating shares on the stockmarket is more palatable than selling a big stake to a foreign investor, as it keeps ownership dispersed and lets the state keep a golden share to stymie any hostile takeover. But in such bearish times, the most promising public offering can flop.

Selling to a local investor is also politically attractive—but there are few with the cash and expertise to restructure distressed firms. Another option is to bring in a tactful foreign investor who promises to keep local management in place and allays concerns over loss of jobs and national identity. “But there are too many bull-in-a-china-shop types,” notes one veteran privatisation adviser.

Novartis, a Swiss drug giant, opted for diplomacy when it bid for Lek, pride and joy of Slovenia's drug industry, less than three months before the country's presidential election last week. Fearing that the takeover would encounter opposition in a country with a history of thumbing its nose at foreign investors, it pledged to preserve Lek's cultural identity and make it the centre of its operations in the region. With the backing of Lek's management, Novartis won round two politically-tinged investment funds that had first rebuffed its offer. It now has the support of over 80% of shareholders. Belgium's less diplomatic Interbrew, on the other hand, is being thwarted in its bid for Slovenia's Union brewery by Lasko, a local rival.

Yet even multinationals that tread carefully can have a rough ride. RWE signed one of Poland's notorious

“social packages” with Stoen's trade unions, promising six-to-seven-year employment guarantees and a one-off “privatisation bonus” for all workers. But this cut no ice with nationalists, who accuse Mr Kaczmarek of “shameful treachery” and are determined to halt the sale of eight more power suppliers to a foreign investor. He would do well to keep his visits to parliament brief.

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Business books

From great to not so good

Nov 14th 2002 | NEW YORK
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Can the market for business books re-engineer itself?

IT WAS 20 years ago this week that Tom Peters published “In Search of Excellence”, kicking off an unprecedented boom in business book sales. By the late 1990s, the genre was minting millions of dollars for publishers. Recently, however, the market has soured. The Harvard Business School Press is rumoured to have lost much of a fat advance for Gary Hamel's recent book, “Leading the Revolution”, whose publication unhappily coincided with the revolution's end. (It was a “great strategic and financial success”, claims HBSP.) Business books slipped from 5.8% of total American book sales in 1999 to 4.2% in 2001, according to Ipsos-NPD, a research firm. The gurus are in despair. “It's a disaster”, says Adrian Slywotsky, a consultant and author of five business books.

Business authors thrive on management fads. In the early 1990s, the fashion was for re-engineering. Then, every two or three years, came another business-schoolyard craze: quality improvement, value-based management and, most recently, the digital revolution. Since the end of the digital revolution, however, the guru market has failed to gel around any big idea. Mr Slywotsky's most recent book, “The Art of Profitability”, was a 23-item list—useful, in the same way that a magazine list is useful (“Ten Ways to Please Your Lover”), but somehow less compelling.

Richard Pine, a literary agent who specialises in business books, blames the recession. In good times, he says, managers like to celebrate themselves, and can afford to indulge pet theories. In bad times, he says, business books remind them of “what they aren't, what they don't have cooking, and what they don't have the budget for”. The wider audience, meanwhile, may have been put off business books by the seemingly endless string of scandals that have followed the collapse of Enron, a Texas energy trader. Certainly, the *Zeitgeist* appears to have challenged the genre's traditional celebratory tone. Mr Pine's great business-book hope for the new year? “Pigs at the Trough: how corporate greed and political corruption are undermining America”. The author, Arianna Huffington, got a “nice, six-figure advance”, says Mr Pine.

Another sign of the changing market is a new bestselling book by Scott Adams, a cartoonist whose 1996 business book, “The Dilbert Principle”, sold 1.4m copies. Mr Adams's subversive message is that all business success (including his own) is the result of blind chance. “I have a keen eye for coincidence”, says the author, who spent 14 years toiling in the cubicle farms of big corporate bureaucracies. “When things worked, they didn't seem a whole lot different to when things failed.” Management, says Mr Adams, “is the delusion that you can change people.” Leadership, on the other hand, “is deluding other people instead of deluding yourself.” Certainly, what with Enron, WorldCom, and the rest, it is hard to deny that of late there has been a Dilbertish flavour to events in corporate America. “This is when I shine”, says Mr Adams.

The fall of countless celebrity bosses has also hit the market for executives' memoirs—at least until they get out of jail. This sub-genre peaked in 2001 with the publication of “Jack: Straight from the Gut”, for which its author, Jack Welch, former boss of General Electric, was paid an advance of over $7m. Although the book has sold well, it is unlikely to have recouped this astonishing outlay, say publishers. Mr Welch's divorce and the recent tarnishing of GE's reputation, meanwhile, are likely to dent paperback sales—unless it includes a kiss-and-tell postscript. The market has big hopes for a new set of memoirs by Lou Gerstner, IBM's former hero-boss, which went on sale on November 12th. As a Christmas stocking-filler, however, it would be unwise to bet against “Dilbert and the Way of the Weasel”.

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Jean-Marie Messier

Touché

Nov 14th 2002
From The Economist print edition

A hot French business book

Get article background

JEAN-MARIE MESSIER, the disgraced former boss of Vivendi, has not disguised his rancour in a new book* out this week, just four months after being evicted from the near-bankrupt media conglomerate that he built. According to extracts published in *Le Monde*, a newspaper that is one object of Mr Messier's contempt, the former mogul spares nobody from his list of conspirators: hedge funds, rating agencies, research analysts, journalists, his own board members and American shareholders.

Most of his venom, though, is reserved for the cabal of French businessmen led by Claude Bébéar, the ex-head of AXA, an insurance giant. Not at the time a Vivendi director, though appointed one the moment Mr Messier was evicted, Mr Bébéar is fingered as the mastermind behind a "hunt *à la française*, with underground networks, hounds, lies and false pretences".

Mr Messier at least concedes that he made errors: six, according to *Le Monde*. He should have pulled out sooner from Vivendi Environnement, a utilities business; refreshed his board of directors; fired Pierre Lescure, iconic head of Canal Plus, sooner; not done so much so fast; managed his relations with French politicians; and heeded warnings from colleagues and family.

Two years ago, Mr Messier wrote his first autobiography, "j6m.com". (His six Ms? "Marie Messier, Moi-Même, Maître du Monde".) He noted that "the sin of arrogance is always in the end a mortal sin." Craving to join America's entertainment elite, he had the arrogance to pursue that dream with a financial recklessness that is only now being unravelled. He still believes that the cause of his undoing was the French corporate elite, not the financial sand on which he built his empire. Hence, perhaps, his ironic final blow: publishing a decidedly un-French exposé—a traditional American form of corporate revenge.

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Face value

How to pay bosses

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Michael Jensen still thinks he has the answer

Get article background

WANT somebody to blame for those disgraced bosses, with their ill-gotten share-option fortunes? Look no further than Harvard Business School, and in particular, at a (now) emeritus professor, Michael Jensen. No academic is more closely linked to the cause of tying a boss's pay to his firm's shares than Mr Jensen (who now works mostly for the Monitor Group, a consultancy). But don't send a lynch mob to the banks of the Charles River. It is not Mr Jensen's ideas that are rotten, but how they have been implemented—and he has things to say about how to fix the present mess that are well worth hearing.

Although he has influenced many aspects of financial economics, Mr Jensen is best known for work on “agency” problems—those that arise when somebody (the “principal”) hires somebody else (an “agent”). Public firms, with their separation of ownership (shareholders) and control (bosses), have been beset by agency problems for as long as they have existed. Mr Jensen first explored how companies might remedy these problems in a paper written with William Meckling, then dean of Rochester University's graduate management school. This was published in the mid-1970s against a backdrop of depressed share prices and lacklustre corporate performance.

Managers manage in their self-interest, the authors said, a claim that, though often deeply resented by managers, is basically true enough. A rational manager with no investment in his firm would have little incentive to maximise its value, and every incentive to use it for his own ends. The smaller the ownership stake a manager has, the more likely he is to channel corporate resources in directions that give him value (perks, empire-building, and so on), and the more effort shareholders have to make to monitor the manager's behaviour to stop him feathering his nest at their expense. Taken to its extreme, a boss without shares might build a comfortable but profitless empire that squandered excess cashflow on shareholder-value-destroying acquisitions. This turned out to be a fairly good description of conglomerates, which were common at the time.

What, then, was to be done? Messrs Jensen's and Meckling's implicit answer was to make the managers into owners, by giving them equity. Later, Mr Jensen expanded the argument, first by arguing for higher levels of executive compensation and a stronger tie to share performance, and then, in a logical progression, arguing that the best way out of America's corporate-structural rut was through leveraged buyouts (LBOs).

By taking a firm private, Mr Jensen saw a way for a boss's incentives to be tightly tied to shareholder returns, for financial discipline to be supplied by big debts, and for monitoring to be done by private-equity firms backing the buyouts. The chance of a hostile LBO would encourage existing managers to improve returns or risk losing their jobs. Mr Jensen's 1989 essay on the subject, in the *Harvard Business Review*, was entitled “The Eclipse of the Public Corporation”. Thus inspired, to a degree, firms took on more discipline-encouraging debt. Managers were paid increasingly with ever-larger grants of share options (often justified by a citation of Mr Jensen's work). But then something happened that Mr Jensen had never expected: the stockmarket bubble.

When Mr Jensen first pondered agency issues, the big problem was under-utilisation of company assets, and their consequent undervaluation. In the 1990s, the most salient corporate-finance problem was

overvaluation—an eventuality seemingly so unlikely that few economists had ever given it much thought.

Drugs in the boardroom

Mr Jensen now thinks that the way in which executive pay was typically tied to share performance through options meant that, in the bubble, the carrots became what he calls “managerial heroin”, encouraging a focus on short-term highs with destructive long-term consequences. Once a firm's shares became overvalued, it was in managers' interests to keep them that way, or to encourage even more overvaluation, in the hope of cashing out before the bubble burst. Doing this not only meant being less than honest with shareholders, or being creatively optimistic with corporate accounts. It also encouraged behaviour that actually reduced the value of some firms to their shareholders—such as making an acquisition or spending a fortune on an Internet venture simply to satisfy the whims of an irrational market.

One answer to this problem—the wrong answer, Mr Jensen says—is to increase monitoring by putting many new demands on corporate boards and on how contracts with managers are structured, which is how he sees the recently passed Sarbanes-Oxley act. That could increase costs sharply, prompting many smaller firms to go private, Mr Jensen believes. (Call it the partial eclipse of the public corporation.)

A better answer, says Mr Jensen, is to retain the link between pay and share price, but to do it in a way that removes the incentive for managers to exploit and encourage short-term overvaluation. Ideally, bosses should not be able to bank most of the rewards for their performance until it has been proved genuine. One method, suddenly all the rage, is to grant managers “restricted stock” that cannot be sold for many years. Mr Jensen is not convinced: restricted stock is more expensive to provide than, and does not penalise underperformance as much as, share options, which may become worthless if a firm's share price falls. Far better, says Mr Jensen, to grant a new sort of customised share option, which is profitable only if the share price not only appreciates, but does so by more than a firm's cost of capital; and which can be exercised only after a long period.

Better-designed share options, not fewer options, is hardly a populist message in today's boss-bashing era. But Mr Jensen may be right that it is what corporate America needs.

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Investment banks

The price of atonement

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Investment banks have been unable to resolve conflicts of interest between their different businesses. Consumers are cross and regulators have their knives out

THEY are in disgrace. Not so much for their role in the financial legerdemain at Enron, WorldCom and the like, but more for the way in which investment bankers shamefully abused privileged information and misled clients on new-share sales (initial public offerings, or IPOs) during the stockmarket bubble. It will be some time before the story of Henry Blodget, once an analyst with Merrill Lynch, fades from public memory.

Mr Blodget, one of the most visible promoters of dotcom shares when the bubble was at its most overblown, was revealed by Eliot Spitzer, New York state's zealous attorney-general, to have been describing the stocks he was puffing to investors as “junk” and “crap” in internal e-mails. In May, Merrill Lynch settled the case brought against it by the state of New York by agreeing to pay a $100m fine. But that was only the beginning of the banks' atonement, a worrying process whose end still seems a long way off.

This week, Mr Spitzer was stirring things up again, with the revelation of an e-mail from Jack Grubman, once Salomon Smith Barney's star telecoms analyst, suggesting that he had upgraded his rating of AT&T in early 2000 not to win the giant telecoms firm's investment-banking business, but to persuade Michael Armstrong, AT&T's chief executive and a board member of Citigroup, Salomon's parent company, to back Sanford Weill in his (successful) attempt to oust John Reed as his fellow-boss at Citi.

Goaded by Mr Spitzer, the Securities and Exchange Commission (SEC), America's securities watchdog, is drawing up plans to force investment banks to make their equity research more independent of their corporate-finance business (such as IPOs). During the boom years, equity analysts at top Wall Street firms were paid to tout new issues that their banks' corporate-finance departments were managing. Hence Mr Blodget's hypocrisy.

Precisely what form any such settlement will take is not yet clear. What is clear is that it will cost the banks a lot of money. There will be some hefty fines to pay. Credit Suisse First Boston, like Merrill Lynch, has already paid $100m in a settlement to avoid court action. In addition, there is an idea floating around that the banks should pay as much as $1 billion over five years towards independent research arms free of conflicts of interest.

Most bankers see this as a cosmetic step that will not discourage research analysts and investment bankers from touting the same stocks: they will just do it less blatantly. In any case, they say, smart customers have always taken analysts' reports with a pinch of salt, scanning them for hard information

and analysis, and paying little attention to the headline recommendation to buy, sell or hold.

Ahead of any new rules and regulations, Merrill Lynch has announced that it has voluntarily put a Chinese wall between its research and corporate-finance teams. Citigroup has gone even further. At the end of October it said it would spin its research and retail-broking businesses into a separate entity, with Sallie Krawcheck, a respected independent research analyst, at its head. Other firms are expected to follow suit.

The banks hope that this will be enough. But the SEC, Mr Spitzer and private litigants still have a long list of cases to bring against them for ramping share issues during the stockmarket bubble and for allocating shares at below-market prices to their friends (often big investment-banking clients—such as Bernie Ebbers, the disgraced former boss of WorldCom). These cases can only damage the banks' image further and tie up their senior executives for years. Any strategic plans that they might have are sure to be circumscribed by the threat of harsh regulation hanging over them.

Crying all the way from the bank

This would be hard enough to bear if business were booming. But it isn't. Many financial firms are being forced to cut staff. Nearly 30,000 are expected to have left the business in London between the end of 2000 and the middle of next year, around 10% of the total headcount. The American securities industry has cut 32,300 jobs since the end of 2001. Morgan Stanley announced this week that it will cut the number of its brokers serving private clients by 5%. Merrill Lynch made a similar announcement last week.

The banks' results for the third quarter of this year, just released, are deepening the gloom (see chart 2). The fat margins that they enjoyed when companies were hungry for scarce capital have disappeared. The volume of mergers and acquisitions (M&A), the once-glamorous pinnacle of the investment-banking business, is about one-third of what it was two years ago, and the business is bringing in one-tenth of the profits that it did then. Deals of $3 billion or more have dried up completely—another sign of the times, as corporate bosses shrink from the big transactions that once fed their star status.

Those bankers still in a job are keeping their heads low. Bonuses this year will be well down on last year, but by no means negligible. The business climate should be allowing senior bank executives, who traditionally spend from October to Christmas wrangling with employees about their performance and what reward it deserves, to be more aggressive and stingy this year. But old habits die hard. Although profits are sharply down, investment banks are in general still sticking to the principle of taking around 50% of those profits into the pool out of which they pay bonuses.

...not looking so good 2

Banks' net profits/losses, 2002, $bn

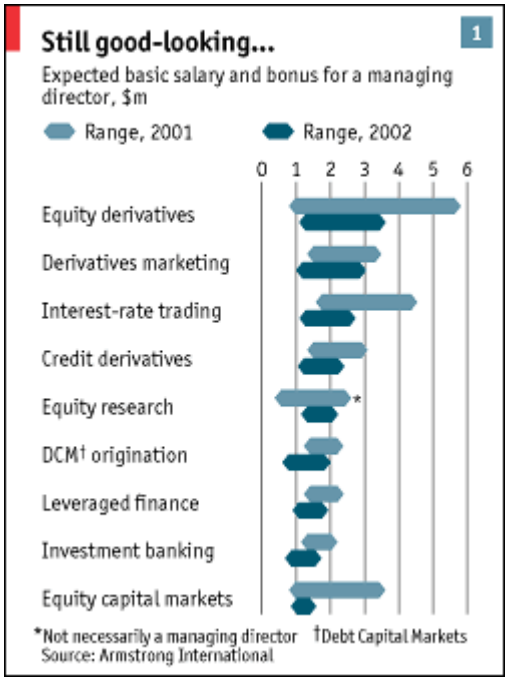
	Q1	Q2	Q3
Citigroup	4.84	4.08	3.92
J.P. Morgan Chase	0.98	1.03	0.04
Morgan Stanley	0.85	0.77	0.61
UBS	0.81	0.84	0.63
Merrill Lynch	0.65	0.63	0.69
Goldman Sachs	0.52	0.56	0.52
Deutsche Bank	0.52	0.19	-0.29
Credit Suisse	0.22	-0.36	-1.30*

Source: Company reports *Forecast

For a few, the rewards will remain intoxicatingly high. According to Armstrong International, a recruitment consultant, senior equity-derivatives specialists at the top three investment banks can expect to take home packages of between $1m and $3.6m this year. A top equity analyst can expect a bonus of over $2m this year (see chart 1). That may explain why signs persist that the profession has not yet lost its cachet: the proportion of fresh Harvard Business School MBA graduates taking jobs on Wall Street rose from 31% in 2000 to 36% for the class ending in 2002. Investment bankers will not have to pawn their Versace suits and Rolex watches just yet. But they are beginning to wear them more humbly than of yore.

Davide Taliente, a consultant with Oliver Wyman, a firm specialising in the banking industry, says this is a one-time opportunity for banks to realign their systems of bonuses and rewards. Designed in the go-go 1990s, these gave bankers inflated pay packets of, on occasions, many millions of dollars. These bonus calculations were flawed, Mr Taliente says, because they were based on a star system, appropriate for Hollywood and sportsmen, but not for bankers. It assumed that the individual alone was bringing in the revenue, and disregarded two important factors: the shareholders' capital that stood behind the business;

and the brand or franchise of the firm for which the individual was working.



Competition and co-operation

Regulators attacking the banks may not stop at stripping out their equity research. But going further will not be easy. Investment banks are among the worst-managed institutions on the planet because they are built on a loose confederation of franchises and outsize egos. Once you start counting conflicts of interest within them, you soon run out of fingers. A lawyer-politician, such as Mr Spitzer, may not appreciate what a Herculean task he is setting for himself should he seek to eliminate all such conflicts on Wall Street.

“Integrated” investment banks' many departments often compete with each other to sell different financial services to the same customer. But they also co-operate with each other (this is then called “synergy”, and is the *raison d'être* for many of the mergers and acquisitions that they themselves put together for others). Their skill, in the old days, was to manage their different businesses well enough to please their customers, and even to convince those clients that they were benefiting from both the internal competition and the co-operation.

In the old days—and that is not so long ago—nobody was moved to correct or punish even blatant conflicts that this gave rise to. For example, in 1997 J.P. Morgan was adviser to both parties in the merger of two German banks, Bayerische Vereinsbank and Bayerische Hypotheken und Wechselbank. Eyebrows were raised, but Morgan's bankers were able to argue that a Chinese wall existed between its two advisory teams, and that no sensitive information was allowed to flow between them. They would have difficulty convincing anyone with such an argument today.

The next year, in 1998, Goldman Sachs raised more eyebrows when it played conflicting roles in the rescue of Long-Term Capital Management (LTCM), a huge hedge fund on the brink of collapse. It was part of a team sent in to investigate LTCM's balance sheet while, at the same time, it was secretly advising Warren Buffett on a possible purchase of the distressed hedge fund's portfolio. At the time there were also rumours that Goldman's traders were trading against LTCM's best interests in the bond and swaps markets. One firm; three highly conflicting activities. Naturally, Goldman claimed they were separated by Chinese walls. Today, in a similar situation, Mr Spitzer or his equivalent would be asking for somebody's head on a platter.

Re-regulating the deregulated

The change of attitude is largely to do with the loss of trust in the intervening years. Investment banks' customers no longer believe that they are not being ripped off. Bankers in Europe argue that the loss of trust there is not as bad as it is in America. But it has spread nevertheless to all the big financial centres. The challenge for the banks is to rebuild it, and to keep ahead of the inevitable demand for more regulation as they do so.

Robert Glauber, chairman of America's National Association of Securities Dealers, reminded the finance

industry during a visit to London last month that bouts of punitive re-regulation by angry authorities can be long-lived. After the South Sea Bubble burst in 1720, a ban on setting up joint stock companies lasted for 100 years. After the Wall Street crash of 1929, it took four years before Congress passed the Glass-Steagall act, which split commercial banking from securities dealing. (Before the legislation bank deposits were frequently diverted in support of new issues by commercial bankers' investment-banking colleagues.) Other restrictive rules continued to be made until 1940.

In recent years the pendulum has swung the other way. There has been a long and unprecedented era of deregulation. The opening shot came in 1975 when fixed commissions on securities issues were abolished in America, opening the cosy world of stockbroking up to competition. In 1986, London's “Big Bang” did the same for the British market. It also allowed banks, securities brokers and jobbers (market-makers in securities), which had previously been separated by law, to deal under one roof.

Glass-Steagall was finally abolished in 1999 because it had already, in practice, been side-stepped by banks and investment houses. American institutions had been forced to find clever ways round the act in order to compete on equal terms with fully integrated European rivals. So integrated are these giant institutions today that they have erased almost all the proud family names that were once synonymous with the stockbroking and investment-banking businesses. This week, UBS announced that it is scrapping the S.G. Warburg and PaineWebber names, noble relics of the days when the industry was more fragmented.

Could regulators, afraid of the free-for-all that they have created, now put the whole thing into reverse? Investment bankers are concerned that re-regulation will not stop until all the businesses that have been steadily integrated over the past two decades—with the encouragement of regulators—have been disaggregated again. The worst-case outcome for them is a forced separation not only of research, but of all trading in equities, bonds and derivatives from their corporate-advisory work. That would change the very nature of financial markets.

It could make even the biggest markets—foreign exchange, government bonds, interest-rate swaps—less liquid. Bid/offer spreads could widen, and there might be less dealing volume. Perversely, the banks' customers could also suffer: companies and investment firms might find it more expensive to hedge their risks or to react to changes in market conditions.

The markets could also be dramatically altered by a draft European Union directive on market abuse. An amendment to the directive, recently approved by the European Parliament, could jeopardise the way that firms use privileged knowledge about their customers' trading intentions. Inside information, the amendment says, also means information related to the client's “pending orders” which, if it were made public, might have a significant effect on prices. A strict interpretation of this would prevent an investment bank from both advising a client on a complex securities transaction and giving him a firm price for the transaction. To do so, the bank would have to negotiate with its traders, at the risk that they would use the information to adjust their prices.

In the real world, of course, that is exactly what integrated market-makers do. Bankers who are advising corporate customers on a securities transaction consult their market-making colleagues. The dealer often knows, or can guess, which side of the deal the bank's customer is on. For a deal involving several complex steps, his all-in price would reflect the cost of hedging his own position. It is a conflict of interest which, outsiders argue, enables banks to make huge sums of money on their proprietary trading (dealing on their own account).

The distinction between market-making for customers in this way and proprietary trading is often blurred, particularly in firms where the market-maker and the proprietary trader sit together or are, indeed, the same person. There is a grey area between a market-maker positioning himself in order to get a “good” price for a client, and his dealing ahead of the client to make a profit for himself at the client's expense—the latter is known as “front-running”. If detected by a client, front-running is usually punished by the removal of his business elsewhere; but it is seldom reported to a regulator.

In the heady days of the bull market, nobody bothered much about all this, because all were making money. Practices and business ethics deteriorated dramatically during the period, and it is now proving difficult to restore them. Britain's Financial Services Authority (FSA) is trying. At the end of October it put out a paper called: “An Ethical Framework for Financial Services”, hoping that ethical standards might be raised to change the continuing public perception that most financial firms are, as the paper puts it, “interested in making money at the expense of all other considerations”.

When the hue and cry from the SEC and Mr Spitzer dies down, it may become clear that the banks have already done a lot to address the public criticism. Many have adjusted their approach to research, and to the probity of financial structures they agree with clients, in the belief that there is now a competitive advantage in offering more transparency and greater (apparent) integrity than other firms. More financial dealings are being done on exchanges and on Internet platforms, where the order flow instantly becomes public information. Moves to outsource parts of their business to other financial firms or processing centres will also be rewarded by the market, as analysts and regulators see more Chinese walls going up.

Market solutions

Whether investors will still be prepared to buy the big integrated banking model is open to more question. The shares of some of the biggest integrated firms, such as J.P. Morgan Chase, Deutsche Bank and Credit Suisse, have been hit more than those of the “pure” investment banks, notably Goldman Sachs and Morgan Stanley. The integration of the different cultures of commercial and investment banking has been difficult to achieve.

In these dark days, the investment-banking industry has found itself short of leadership. Sanford Weill, Hank Paulson and Stanley O'Neal, bosses respectively of Citigroup, Goldman Sachs and Merrill Lynch, have tried to take on the mantle. But Mr Weill has been drawn too closely into the investigation of the activities of Mr Grubman; Mr O'Neal is too new to the job; and Mr Paulson, after an early surge of activity, has gone quiet.

The world's big financial regulators are short on leadership too. The SEC lost its chairman, Harvey Pitt, last week, closely followed by the agency's chief accountant, Bob Herdman, and William Webster, Mr Pitt's nominee for the top job at the new accounting oversight board mandated by the Sarbanes-Oxley act. The voice of Bill McDonough, chairman of the Federal Reserve Bank of New York, has been remarkably silent of late. On the other side of the Atlantic, Sir Howard Davies, chairman of the FSA, is more preoccupied with the minutiae of retail finance in Britain than with the world's major financial firms.

Despite the sins of the past, it makes both practical as well as theoretical sense to leave the big investment banks to run themselves. The greater transparency being demanded by the market should ensure that the worst abuses of the bubble years are not repeated. The market itself provides plenty of sanctions against wrongdoers: the loss of customers; downgrades by credit-rating agencies; and punishment of the share price. Now the market has seen that the investment-banking industry's business model is flawed, best leave it to sort out the mess.

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German insurers

Twist, twist, bust?

Nov 14th 2002 | FRANKFURT
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Germany's life insurers have gambled away their strength

HAD they played their hand differently, this could have been a time of modest satisfaction for Germany's life insurers. Right now, you might expect German savers—a cautious bunch at best—to place a special value on boring security. The economy is anaemic. The public's torrid love affair with the stockmarket has ended painfully. The state pension system is beginning to crack. And the government is prodding savers, with subsidies and tax breaks, to put money into personal and company pension plans.

So what could be better than good old life insurance? Life policies, provided they run for 12 years or more, are tax-favoured. Insurers are obliged to pay out more than 90% of their post-tax profits to policyholders. It is no surprise, then, that insurance policies make up one-quarter of German households' financial assets (only bank deposits have a bigger share, and this is declining). Last year, life insurance accounted for more than half the accumulation of new assets.

Until now, policyholders have done nicely. On endowments, which account for more than half the premiums paid, they are guaranteed a minimum annual bonus of at least 3.25% for policies started since 2000, and 4% on those taken out in the six years before that. In fact, they have been promised, and are getting, much more: about 6%, this year and last, after several years of 7%-plus. But unfortunately market reality has now caught up with the life insurers.

Next year's bonuses, which will be announced in the next few weeks, are unlikely to exceed 5% on average, says Dirk Popielas of Goldman Sachs. Fitch, a rating agency, thinks several firms will come down to the minimum. Life insurers' problems, says Mr Popielas, stem partly from the way that bonuses are fixed. They decide at the end of one year what they will pay the next, and then have to find the money to keep their promise. This makes them, he points out, “12-month investors”.

That is risky, since liabilities last for decades. Certainly, if insurers suffer the odd bad year, they can dip into their reserves (and build them up again in times of plenty). But they have now had three lean years on the trot. Low inflation has meant low yields on bonds, their staple assets. Because bond yields were so disappointing and stockmarkets were roaring, German life companies waded into shares in the late 1990s. Then came the stockmarket crash. Many portfolios are probably under water—if they have not had to be sold.

The result has been a dramatic erosion of the industry's former financial strength. At the end of 1999, according to a Fitch survey covering 75 of Germany's 118 life firms, the average capital-adequacy ratio (capital plus reserves, divided by an actuarial assessment of capital required) was an “exceptionally

strong" 185%. By the end of 2001, it was a "moderately weak" 76%. Three firms did not have enough capital and reserves to cover the bonuses they promised in 2002; another 39 insurers were less than two times covered. The position has surely deteriorated since.

Not surprisingly, regulators are watching some companies nervously. The portfolio of Familienfürsorge, a mutual serving mainly clergy, was taken over by another insurer, HUK-Coburg, earlier this year. Hannoversche Leben, also a mutual, replaced its management last month at the regulator's behest. Smaller companies, which tend to have thinner hidden reserves, are most at risk.

30% of companies could disappear in the next three to five years

Rumours that some firms might go under are the wildest speculation, said the German Insurance Association on November 13th. Nonetheless, the industry is setting up an organisation, called Protector, to take over the obligations of life firms that get into trouble. Goldman's Mr Popielas thinks that 30% of companies could disappear in the next three to five years, through mergers, via Protector's intervention or by ceasing to write new business. Such a consolidation has long been predicted, gleefully, by the industry's (basically healthy) bigger firms. The top four groups already account for 40% of premiums. There is a long, thin tail of smaller companies.

For those that survive, does a brighter future beckon? Maybe, but it will help to be big, or at any rate well-capitalised. German pension reform should push a lot of cash the insurers' way: Goldman Sachs estimates that life insurers will scoop two-thirds of the *euro*310 billion ($310 billion) expected to be poured into company and personal schemes by 2010. However, the take-up, especially of personal plans, has been disappointing.

Most of the business is likely to come from providing or administering company or industry pension schemes, rather than writing personal life contracts. That favours big firms ahead of the minnows. So might the government's requirement that private pension-scheme investors get at least a zero return. This is not costless. Larger insurers should find it easier to budget for possible losses, just as they have been better able to bear a performance falling short of guaranteed returns.

The industry can ill-afford another wretched year. Lower minimum guarantees—or none at all—would help. Deciding on bonuses at year-end, rather than competing to make rash promises, would make risks easier to manage, and might also educate investors that their savings are not immune from market swings. In any event, Germany's insurers will have to match their risks and liabilities much more closely than they have done so far. "We believe", write Mr Popielas and his colleagues in a recent study, "that risk management will be the trend of this decade." Shame it wasn't the trend of the last.

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Wall Street's messy reforms

Dog's dinner

Nov 14th 2002 | NEW YORK
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The pillorying of the financial species continues apace

WITHOUT a charge even being filed, the financial industry suffered yet another week of humiliation. William Webster, who had survived tenures atop the FBI and CIA without destroying his reputation, stood down on November 12th from the leadership of the new Public Accounting Oversight Board. His peccadillo: having headed the audit committee of a company under investigation for fraud. “My continued presence on the board will only generate more distractions,” he said.

His departure followed the resignations of the Securities and Exchange Commission's (SEC's) chief accountant, Bob Herdman, on November 10th and of the SEC's chairman, Harvey Pitt, on November 5th. One consolation is that the list of obviously vulnerable public servants is now largely exhausted. But, in today's environment, it would be foolish to predict that anybody is beyond reproach—which complicates the process of filling the vacancies. Some regulators believe that it will be next summer before the SEC is functioning normally again.

AP

Spitzer, scourger-in-chief

Meanwhile the public flogging of Wall Street continues. Eliot Spitzer, New York state's attorney-general, who is leading the charge, embarrassed his hosts at an awards dinner for securities analysts by claiming that their awards were used “deceptively” to prove stock-picking ability. An independent study done by Mr Spitzer's office, he said, “suggests they do no such thing”. In fact, Mr Spitzer said, citing his own statistics, the reverse is probably true. Worse, he added, Wall Street firms' jealously guarded data made it almost impossible for customers to assess analysts' performance. Two award-winners stormed out of the dinner; others squirmed in their seats.

Who knows whether Mr Spitzer's evaluation is any better? He looked at 51 categories; *Institutional Investor*, the award giver, evaluates more than 70. He used a one-year time-frame; the voters may be considering a longer period. His methodology was not included as part of his speech. *Institutional Investor* ranks stock-picking ability only 11th in importance among the institutions it polls, behind industry knowledge, accessibility, and financial models. Recently, customers of investment banks have had plenty of information on analysts' rankings, even if the broader public has not. It seems that Mr Spitzer, even at this dinner, was continuing his trial by denunciation, avoiding the trouble and public expense of actually taking anybody to court. Citigroup, top of Mr Spitzer's scourge-list, came top of the poll, incidentally.

Yet Mr Spitzer's public naming and shaming may have a virtuous impact of its own. In most firms, there is anger among many employees seething at those who made fortunes doing deals that subsequently lost the firm not just money but also reputation. They killed the goose that laid the golden egg. Moreover, the cost of these disasters has often been borne by everybody bar those responsible. Recent decisions on pay and redundancies have been brutal too. There may be no constituency more supportive of Mr Spitzer than the rank and file—including the former rank and file—of many banks: he is seen as the only public official bold enough to take action to bring people to account. That groundswell of opinion in rarefied Wall Street could be what rescues these financial firms from themselves. Today, virtue has a street value that even the most hard-nosed of Manhattan are beginning to acknowledge.

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Chicago's exchanges

Pit bulls

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Chicago's oldest exchange won't junk the trading floor

SOME prefer to bet money coolly and quietly, others in a frenzy of shouts and sweat. Both opportunities exist at the Chicago Board of Trade (CBOT), with its combination of pits and computer screens. The 154-year-old futures exchange seems in no hurry to abandon itself to the virtues of electronic trading. Some suspect that it may even shelve its alliance with Eurex, the Swiss-German electronic derivatives exchange, such is the reluctance of some members to move with the times.

Earlier this month, David Vitale resigned as the CBOT's chief executive after only 18 months (the latest in a string of management turnovers). He had been hired during leaner times to lead a restructuring that would have moved the CBOT to a shareholding structure and, most likely, to fully electronic trading. But he hit a brick wall: when a surge in market volatility drove up volumes, the CBOT's members, particularly those with seats in the tradition-bound grain exchange, lost their appetite for reform.

Frustration with the slow pace of change is palpable among some CBOT clients and brokers who bear the double expense of pit-based and electronic trading. “They've done nothing the last two years,” complains Patrice Blanc, chief executive of Fimat Group, a French-owned firm with a team at the CBOT. “They're saying ‘life is beautiful’, but it's very dangerous.” He fears that less volatile times will hit revenues hard. Life has indeed been beautiful for some. CBOT volume in October was 67% higher than a year earlier, but even that surge has failed to keep pace with rival exchanges.

More than three-quarters of the CBOT's 1,402 seats are in the grain-trading room, with its culture of sharp elbows and gruff camaraderie. A majority of the grain-trading seats are owned by retirees and others who lease them out and reap the rewards from a distance (including the poolside in Florida). They are unconvinced by electronic trading, fearing a volume surge they cannot handle, diminished control, and reduced incomes.

Their colleagues in the Treasury-bond futures market—the CBOT's biggest revenue-earner—do many multiples of their floor-trading business in the electronic market. That is partly thanks to a joint venture with Eurex, called a/c/e (Alliance CBOT Eurex). Rudolf Ferscha, chief executive of Eurex, eagerly displays charts showing the reversal of the CBOT's declining trading volume after electronic trading began on a/c/e in August 2000.

The a/c/e alliance, which was renegotiated a couple of months ago, expires in January 2004, and new talks are under way. That leaves little time for the CBOT to find another electronic partner. Every day thus increases Eurex's chances of extending the alliance. Mr Ferscha and Bernard Dan, the CBOT's new chief executive, say relations have warmed, but outstanding issues remain. Eurex is unlikely to accept a deal that excludes it from a share of the lucrative market in Treasury products.

Meanwhile, the CBOT is holding a beauty contest to evaluate a couple of other trading platforms. The Chicago Mercantile Exchange's (CME's) Globex system, though not being officially evaluated, is favoured by those who want the Chicago exchanges to merge. Egos have so far prevented this. “They'll go 5,000 miles away for a system rather than swallow their pride,” says a former CME official. Nonetheless, last week's launch of single-stock futures trading on OneChicago—a joint venture between the CBOT, CME and CBOE (Chicago Board Options Exchange)—may prove they can co-operate after all.

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Corporate finance

Convertible bombs

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A gambit to escape the commercial-paper crunch backfires

ONE explanation for the wretched share performance of many American companies is the wretched condition of their industries. But the pain of a tough economy was compounded, in some cases, by a bull-market bias in their balance sheets.

Many large companies are facing agony after making use of a special form of convertible bond known as “quasi-commercial paper”. The stuff was hugely popular last year, when it seemed an ideal solution to their problems. In late 2000 and during 2001 the commercial-paper market became increasingly restrictive after some well-publicised blow-ups, including Finova, a finance company, and Xerox. That forced many companies out of the short-term debt market and into the more expensive long-term market. At the same time, share prices had become more volatile. It was not long before creative financiers on Wall Street came up with an idea that magically seemed to restore their clients' access to low-cost debt.

The trick was a special kind of long-term convertible bond. As usual, it would allow buyers to benefit from any significant rebound in the share prices of sponsoring companies. The catch was a put option that allowed investors to force companies to repurchase the bonds at their original price at a future date.

Enthusiasm for these convertibles grew fast, and bonds outstanding rose from $10 billion at the end of 2000 to $32 billion in 2001, according to Morgan Stanley. The effective coupon on this debt was less than commercial paper—in most cases under 2%. But the put option was a nasty sting in the tail once the markets turned mean.

As an issuer's prospects dimmed, its share price would fall. That made the likelihood of being able to convert debt into equity increasingly remote, and gave bondholders less reason to hang on to their bonds. Credit considerations might make them want to bail out anyway. So, just as a company's need for cash was growing, and its sources were drying up, there was a threat of being forced to repay the bonds. That triggered fears among shareholders that companies needing to repay bonds would tap the equity market for the necessary cash, and dilute their shareholding accordingly.

As in so many other problem areas of finance, the groundbreaking company was Tyco. On December 4th 2000, Tyco issued $5 billion in face value of convertible bonds, maturing in 2020. The interest rate was a meagre 2%. Buyers had the opportunity to sell back the securities to Tyco on November 17th 2001. A time line drawn up by Anand Iyer, global head of convertible research at Morgan Stanley, gives a curious picture of how Tyco managed to get by. Just days before the decision date, the Fed cut short-term rates, increasing both the attractiveness of Tyco's yield and the prospect of an economic rebound. Then Tyco held an upbeat investor meeting, stoking demand for its shares. The put option was largely ignored, much to the regret of many investors, given Tyco's later nosedive.

They have been less forgiving since. All the companies forced to repurchase all or part of their convertible issues, including Solectron, Anadarko Petroleum, Calpine, Stillwell Financial, Marriott and US Bancorp, have seen their stock hit hard. Interpublic, a large advertising agency, has a put date next year, which has almost certainly played a role in driving down its share price from $35 this summer to $13. Other companies, including Cendant and Neuberger Berman, have bought off investors by sweetening terms, such as adding an interest payment, call protection, or opportunities for future puts.

All the companies forced to repurchase all or part of their convertible issues have seen their stock hit hard

If there is any benefit in issuing these convertibles, it is the effect of forcing a financial restructuring. The

debt reduction comes at the expense of equity holders, as in a bankruptcy, but without the drama or the cost, observes Alan Muschott, manager of a convertible-securities fund run by Franklin Templeton. It is an elegant solution to a problem, even if not quite the one companies had in mind when they issued the bonds.

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Italian corporate bonds

Cirio folks

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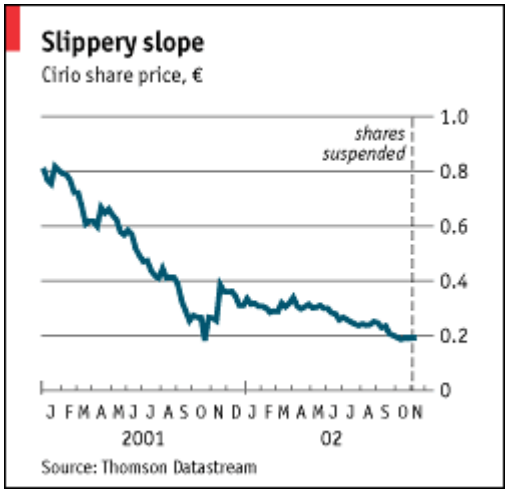
From The Economist print edition

A household name declares Italy's first corporate-bond default



THERE is nothing flashy about Cirio. A simple processor of food, the firm is a household name in a country where tomatoes like those in its cans are on the table every day. Now Cirio has won unwelcome brand recognition. It failed to repay investors who expected *euro*150m ($150m) when their bonds matured. Default was declared on November 8th, the first time that an Italian corporate bond had suffered such indignity.

This was bad news for investors who had bought *euro*275m of Cirio's bonds last year, and a further *euro*125m earlier this year. Default on any bond repayment may trigger a cross-default clause and immediate demands for repayment of all other bonds issued by the company. That would force Cirio to find a total of *euro*1.1 billion in cash for its bondholders. The company was talking to banks and advisers this week: sorting things out will take time.

The company's recent results should have made investors wary of buying Cirio's bonds: losses of *euro*81m in 2000 and *euro*12m last year. Failing that, the complex chain of offshore companies that Cirio had strung together might have sounded a warning. Apparently not. Bond buyers leapt at the household name and ignored the fact that the bonds were not assessed by any credit-rating agency. In Italy that is not uncommon. Well over half the corporate-bond issues in Italy in the first nine months of this year—around *euro*2.7 billion worth of bonds—were not rated. Nevertheless, some salesmen suggested impishly that these bonds had “implicit” ratings.

The biggest losers from Cirio's default are small savers who bought the bonds at their high-street banks. They probably hold about 60% of the bonds outstanding. But the default will hit more than Cirio's creditors. The market for all non-rated bonds has turned illiquid and the appetite for issuing new ones has, not surprisingly, vanished.

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China's stockmarket

A tiny leap forward

Nov 14th 2002 | HONG KONG
From The Economist print edition

China's first cautious step towards an open capital account

JUST as China's leaders were gathering in Beijing last week for the 16th congress of the Communist Party, the country's securities and foreign-exchange regulators announced that, from December 1st, they would consider applications from some foreign investors to invest in the Chinese stockmarket. Whatever the cadres decide this week, the timing seemed to say, China will continue on its slow and cautious path towards an open capital market and, ultimately, a convertible yuan.

The new scheme—known as QFII, because it is aimed at the qualified foreign institutional investor—is an import from Taiwan. A decade ago Taiwan, just like the mainland today, badly wanted foreign capital to beef up its stockmarket. But it was cautious about encouraging volatility (for fear that the mainland would exploit it). So it added swathes of bureaucratic red tape, which were sufficiently obstructive to deter all but the most dedicated investors, and cumbersome enough to cool down most “hot money” long before it could exit from the market. QFII has worked for Taiwan, saving it from the worst of the Asian crisis in 1997-98. Today, foreigners own some 7% of Taiwan's stockmarket, and the government has said that it is ready to open up completely by 2004.

The mainland is hoping for a similarly slow evolution. Its entry conditions are onerous. To apply for the special yuan accounts, foreign investors must have at least $10 billion in assets under management (which rules out most investment boutiques). Banks must be “in the top 100” globally. Applications will take 30 days (in theory), and the QFII may buy at most 10% of any Chinese company listed on Shanghai's or Shenzhen's yuan-denominated stockmarkets (foreigners can already invest in China's tiny hard-currency stockmarket). And repatriation will be a nightmare: some types of funds may not take anything out for three years, others not for a year, and even then it will only be in small dollops.

The barriers are intentional, but that is only one reason why international fund managers were not exactly fighting in the queue for applications this week. The other is the peculiar nature of China's market. Capitalised at about $540 billion and consisting of 1,212 companies, it is now Asia's second-largest, after Japan's. But only 35% of this capitalisation is tradable, since the state—the owner of virtually all listed companies—sits on the rest. Corporate governance is widely acknowledged to be atrocious. And valuations are probably overdone, with an average price/earnings ratio of 40, compared with about 12 for mainland companies listed in Hong Kong. That is despite a fall in the market of some 30% over the past 17 months.

Chinese investors themselves seemed to acknowledge these shortcomings this week, by not anticipating a rush of foreign interest: the market barely moved. In time, China's leaders hope, foreigners will support the market and force managers and brokers to become cleaner and more transparent. Even in Taiwan, though, this did not happen overnight.

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Foreign-exchange settlement

Plumbing revolution

Nov 14th 2002
From The Economist print edition

Since September the foreign-exchange market may have become less dangerous

THE water closet, patented in 1819, was not a particularly exciting invention, but it certainly proved useful. The same may soon be said of continuous linked settlement. The past few weeks have seen a long-awaited revolution in the foreign-exchange market, the biggest market in the world. Banking customers may not notice the difference, unless—as the water closet sometimes does—it goes wrong. But such a big change has not occurred in international banking since the introduction in 1974 of SWIFT messaging, which gave banks instant and secure worldwide communication with one another.

Like SWIFT, the new system will change the relationship that banks have with their biggest customers and with each other. It will encourage some banks to become dominant “deal factories” through which more and more of the world's foreign-exchange deals, and perhaps other transactions, are processed. The aim is to reduce risk, by introducing greater trading certainty. But it may, in the view of some, be adding new risk, by concentrating all that certainty in one place.

At the heart of this revolution is CLS Bank, a purpose-built bank in New York that undertakes to settle foreign-exchange trades among the world's 60-or-so biggest banks, thereby eliminating the risk that only one party to the transaction pays up. This risk is called Herstatt risk, after a German bank that was closed halfway through a trading day in 1974, leaving the dollar side of its foreign-exchange trades unpaid. The bank's failure caused panic and gridlock in the entire foreign-exchange market, which took weeks to unravel. Regulators have been nervous about a possible repeat performance ever since.

CLS Bank is designed to take details of all trades, and by midnight central European time (CET) to give banks an orderly schedule of when each bank must make payments during the following day to honour them (CLS stands for continuous linked settlement). A single payment of a few million dollars, yen or euros is then enough to settle a bank's multiple trades scheduled in that currency for that day, even though their gross value may be hundreds of millions of dollars.

It took many years, and perhaps $1 billion spent by banks, and central banks to adapt their systems, before dealing went live in seven main currencies on September 9th. On November 4th third parties—the settlement banks' customers—were allowed to enter the fray. But only half a dozen did so. It is taking time, and a complete systems overhaul, for the global revolution to spread from bigger to smaller banks. In two months of operations, there have been no major glitches, it is said, apart from linkage problems between CLS and some central banks. On October 29th CLS Bank settled 15,200 transactions, totalling $395 billion, which required only $17 billion of payments between member banks, a 95% reduction. As more banks and more currencies join, the risk reduction should be even greater.

On October 29th CLS Bank settled 15,200 transactions, totalling $395 billion, which required only $17 billion of payments between member banks

What is so new in all this? First, payments are no longer bunched at the end of each currency's working day—the banks have to make payments according to a schedule set by CLS Bank, usually ending before midday CET. So banks, and their central banks, have to fine-tune their use of liquidity during rather than at the end of each day.

Since there is a value in having intra-day liquidity, interest might soon start to be charged, like some hotel rooms, by the hour rather than by the day. For example, for the Swiss franc, one of the less liquid currencies, the two big Swiss banks are already talking of charging non-Swiss banks for any intra-day liquidity they provide. Bank treasury departments say they are resisting this trend—nobody wants to be first, although the Federal Reserve already charges for Fed funds by the minute, and the Bank of Japan

charges a flat rate every four hours.

Second, the nature of correspondent banking will change. Banks outside the CLS inner circle will favour a relationship with just one CLS settlement member, rather than with many, for administrative reasons. So that single relationship will become more important. Strangely this does not seem to alarm the competition authorities around the world. “CLS is not a closed shop,” comments John Gibbons at ABN Amro, a big bank and one of the initial 39 CLS settlement members.

Third, if CLS Bank proves successful it will not be satisfied with settling only big-bank trades in the $1.5 trillion-a-day foreign-exchange market. Joseph de Feo, chief executive of CLS Bank, has already talked of settling money-market trades, and of settling cross-border payments for securities. Cross-border securities transactions are probably the biggest source of cross-border cashflow today.

In CLS we trust

Although CLS Bank is a private-sector creation, it has required unprecedented co-operation between central banks. They have linked their real-time payment systems together in a bank supervised by one of them, the Federal Reserve Bank of New York. Now some big banks want the central banks to co-operate even more closely and allow them to swap their liquidity from currency to currency during the business day.

For example, by arrangement with the Fed and the Bank of Japan, a Japanese bank posting collateral with the Bank of Japan would gain access to Federal Reserve dollars in New York. A global multi-currency collateral pool would do the trick, argues a working group of the private New York-based payment risk committee. Other banks think the same could be done via a multi-currency pool within CLS Bank (at present banks must put up collateral in each of the seven currencies, and are helping each other out bilaterally with so-called inside/outside swaps).

Whichever route is chosen, the outcome should be a further reduction of settlement risk. But, as Richard Pattinson, a director of Barclays, points out, risk tends to be squeezed from place to place like air in a balloon, rather than eliminated. CLS Bank decreases Herstatt risk, but it increases banks' exposure to two other risks: liquidity risk (the need to pony up cash several times a day on a strict schedule), and operational risk (the chance that a failure of their system, or of CLS Bank, could cause a mighty hiccup). A CLS Bank hiccup would be global, hitting seven payment systems with one blow. But time and money have been spent to ensure that doesn't happen. In CLS we trust—and hope.

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Economics focus

Europe's work in progress

Nov 14th 2002
From The Economist print edition

Why does Europe's productivity growth lag so far behind America's?

AMERICA'S short-term economic prospects may be fragile, but at least its productivity continues to impress. In the year to the third quarter, labour productivity grew by 5.3%, the fastest rate for 19 years. In contrast, the European Central Bank's latest figures showed virtually no increase in productivity in the euro area in the year to the second quarter. Since the mid-1990s America's productivity growth has quickened, Europe's has collapsed.

Europe's failure to reap the same productivity gains as America is often blamed on its more rigid labour and capital markets, which prevent firms from taking full advantage of information technology (IT). But this is overly simplified. Not only is the productivity gap between America and Europe exaggerated by measurement problems; labour-productivity growth is also a poor gauge of Europe's performance, since labour-market reforms are meant to pull lower-skilled workers back into jobs.

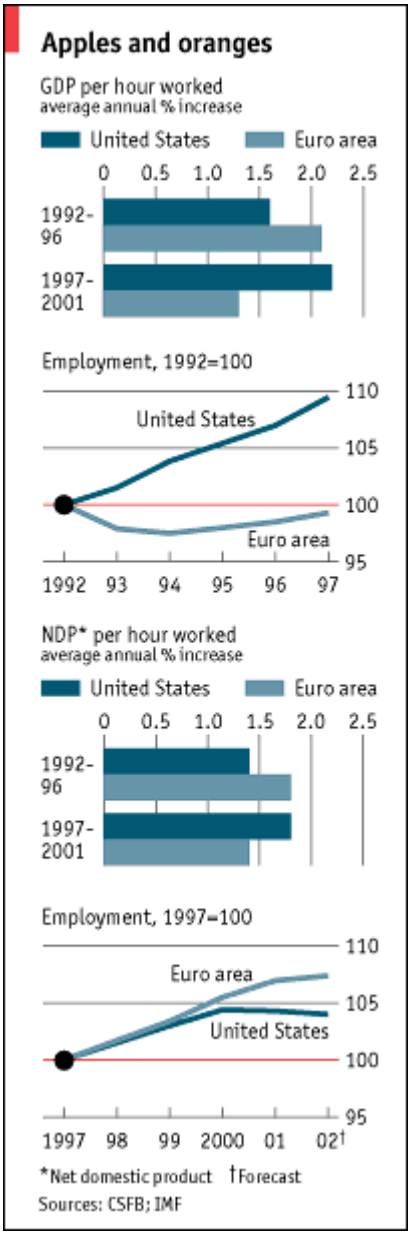
There are many ways to measure productivity. America has chosen the most flattering one, the euro area the least flattering. American official statistics use output per man-hour in the non-farm business sector. Growth in this averaged 2.3% a year in the five years to 2001. By contrast, the productivity figures that the ECB publishes for the euro area use GDP per worker in the whole economy. Growth of this has averaged less than 1% over the past five years. Unlike America's, this measure includes the public sector, which tends to have slower productivity growth. By taking output per worker rather than output per hour, it also ignores the fact that average hours worked have fallen as part-time jobs have risen, depressing average output per worker.

If one calculates GDP per man-hour for both economies, labour-productivity growth in the past five years has averaged 2.2% in the United States, against 1.4% in the euro area. America still leads, but by a narrower margin. Yet even these figures are comparing apples with oranges. One important difference is the treatment of computer software. American statisticians count firms' spending on software as investment, so it contributes to final GDP. In the euro area, software is instead largely counted as a current expense, and so is excluded from final output. The surge in spending on software in the late 1990s therefore inflated America's growth rate relative to Europe's.

François Lequiller*, at INSEE, France's statistical office, argues that one way to resolve this problem, at least in part, is to use net domestic product (NDP), which deducts capital depreciation, rather than gross domestic product. Normally GDP and NDP grow at roughly the same pace. But in recent years a significant gap has opened up between the two in America, as the rate of capital depreciation has risen sharply thanks to a surge in investment in computers and software, which have much shorter lives than traditional machinery. Europe's investment in software, as officially measured, is much lower, so the difference between GDP and NDP growth in recent years has been negligible. Julian Callow at CSFB calculates that in the five years to 2001 productivity, measured by NDP per hour, rose by 1.8% a year in America and by 1.4% in the euro area—a much narrower gap.

Whichever figures one uses, though, labour-productivity growth has risen over the past decade in America, but fallen in Europe (see chart). One reason is that American firms invested more heavily in IT equipment than European firms in the 1990s, boosting the capital stock per worker. This is why many economists prefer to focus on multifactor productivity, the

increase in the efficiency with which firms use both capital and labour. But that is even harder to compare sensibly across countries.



On the flip-side

One explanation for why productivity growth in Europe has slowed is that reforms to make labour markets more flexible have deliberately made GDP growth more job-intensive. More flexible workplace arrangements, such as part-time jobs and fixed-term contracts, have allowed firms to get around job-protection laws and so encouraged more hiring; cuts in social-security contributions for the low-paid have priced some of the jobless back into the labour market. The flip-side is lower average productivity growth, as more unskilled and inexperienced workers enter the workforce.

Labour-market reforms in the euro area have been more successful than is often appreciated. Participation rates have risen, and unemployment has fallen. As a share of the population of working age, employment has risen from 59% in 1996 to 63% last year. Over the past five years, employment has increased at an annual rate of 1.4%, even faster than America's 0.8% rate of expansion and a huge improvement over the previous five years, when jobs declined by 0.1% a year.

Michael Dicks, at Lehman Brothers, estimates that the euro area's structural rate of unemployment (ie, the lowest jobless rate consistent with stable inflation) has fallen to 8% of the labour force, from 10% five years ago. The OECD reckons that the structural unemployment rate has fallen everywhere in the euro area bar Germany and Greece, where it has risen. It is striking that productivity growth has slowed by more in countries with the strongest employment growth. In Germany, by contrast, where a still sclerotic labour market has created fewer jobs, productivity growth has held up better.

To blame slow productivity growth on market rigidities may therefore miss the point. Europe needs to make its labour markets more flexible, but in the short term that may depress productivity growth. On the other hand, this excuse for Europe's disappointing performance is not an excuse for postponing

deeper reforms. European governments still have much to do.

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* “The new economy and the measurement of GDP growth” by François Lequiller. INSEE working paper G2001/01, February 2001.

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Human space-flight

2020 vision

Nov 14th 2002
From The Economist print edition

NASA does some fancy financial footwork to deal with a budget crisis

Get article background

FIVE BILLION dollars is a lot of money. A line of dollar bills five billion long would reach to the moon and back. Finding that you have a $5 billion budget shortfall—as NASA, America's space agency, did last year—is therefore no mean feat.

Cash crunches are nothing new at NASA, but this one is more serious. In the past, when the agency has waved its begging-bowl before American politicians, the bowl has usually been filled. This time, neither President George Bush nor Congress is interested in letting NASA spend its way out of its problems. A true crisis has finally arrived. And, a year ago, Mr Bush appointed Sean O'Keefe, a self-professed “bean-counter”, to deal with it.

Opportunity knocks

The Chinese ideogram for “crisis” combines those for danger and opportunity. The opportunity for NASA is to scale back some of its over-ambitious plans for human space-flight and to try and stick to a budget. The danger is that, even if scaled back, most of this programme is pointless, and it would be unreasonably expensive even if it had a point.

Roger Pielke, director of the Centre for Science and Technology Policy Research at the University of Colorado, Boulder, says that when NASA's grand vision of a mission to Mars was turned down almost 30 years ago, it broke its proposal into three smaller parts that were easier to smuggle past the politicians. One was a reusable launch vehicle; the second, a space station; and the third, further off, a putative Mars mission. But this meant that NASA had to sell the shuttle and the station individually and on their own, rather dubious merits.

It is this, says Dr Pielke, that has led to NASA's big problem. The shuttle, it was promised, would make access to space more affordable. Instead, it became more expensive. The suggestion was that shuttles would fly every week at a cost of $14m a pop. In fact, the four-to-six launches a year that the agency now manages cost roughly $400m each. The space station, meanwhile, was supposed to cost $8 billion when it was first assessed in 1984, and it was meant to take a decade to build. The total cost of the project, when it is completed (which is not yet), is now put at some $100 billion.

For now, the budget crisis has put NASA in a holding pattern—trying to keep all its assets afloat. Details of its long-term strategy will not emerge until its 2004 budget request. But both inside and outside the agency, questions are being asked about what its core mission should be.

That NASA is serious about changing is suggested by an unusual budget request that the agency has just put to Congress. The request is unusual because it is not for more money, but rather to shuffle the existing budget around. Previously, NASA was planning to spend $4.8 billion on the groundwork for a fully reusable launch vehicle to replace the shuttle. Now, itwants to divide that money between the space station (allowing crews to do some actual science there) and the development of a reusable “orbital space plane” (OSP) that would be launched on top of a cheap expendable rocket.

If the request is approved, it will represent a big change of strategy, since research has already started on a fully reusable vehicle. It will also be a move in the right direction. According to Antonio Elias, vice-president of advanced programmes at Orbital Sciences Corporation, a commercial-satellite company based in Dulles, Virginia, a reusable vehicle would take 15-25 years to pay back its development costs—three times longer than an OSP. Furthermore, he says that fully reusable craft are hard to justify at all unless they can be flown at least 50 times a year.

Since global demand for launches is expected to run at between 30 and 40 “shuttle equivalents” a year over the next two decades, the numbers scarcely add up. The economic rate for reusable vehicles, says Dr Elias, has not changed for decades, because the two fundamental parameters of rocketry—the efficiency of rocket engines and the properties of structural materials—have not changed.

An OSP could, it is reckoned, be ready by 2012. It would have two functions. The first would be to provide a cheap way of transferring crew between earth and the station. The second would be to act as a lifeboat for the station, a role now filled by a Russian-built Soyuz capsule that can house only three people.

NASA would still need to be able to get to the space station in the interim, however. It therefore proposes to extend the life of the shuttle programme. Not everybody is happy about this. Some are concerned that the shuttle fleet, which is two decades old, will become increasingly costly to run at present levels of safety and reliability. Even now, the fleet costs $3.8 billion a year, including its fixed costs. That is a significant chunk of NASA's $15 billion annual budget. And the $400m marginal cost of a launch is ludicrous compared with the $60m that the Americans pay for a Soyuz mission. Objectors thus believe that what is really needed is an “exit strategy” from the whole sorry mess.

The question is: what? There are precious few options. One is privatisation. Some time over the next few weeks an independent report on privatising the shuttle fleet will land on Mr O'Keefe's desk. However, one of the report's compilers, Peter Wilson of RAND, a think-tank based in Santa Monica, California, says that the overall view it will take of the possibilities for privatisation is “very pessimistic”. Because the shuttle is such old technology, says Mr Wilson, and is also expensive to operate safely, it is unlikely that any private enterprise would wish to acquire it without a direct subsidy. In any case, there is only one market for it—to service the space station. It is therefore unclear what benefits would flow from full-fledged private ownership.

One suggestion in the report is that NASA could restructure the shuttle programme to allow more competitive sourcing. Another is that the programme could be hived off into a new “space transit authority”. Although this would merely create a different public monopoly in manned space travel, it might have the benefit of getting NASA out of the business altogether and forcing it to focus on what should be its core competence of science and technology.

There is one other alternative to the shuttle fleet—more use of Soyuz. But according to Scott Giles, the deputy staff director at the House of Representatives' Committee on Science, that will not work either. The crunch will come with the expiry in 2006 of agreements to buy Soyuz vehicles from Energia, the company that makes them. According to Charles Vick, an independent space analyst, Energia could not build more Soyuz craft after 2006 even if the agreement were renegotiated, because the programme is nearly bankrupt and is already running down in anticipation of its expiry (money supplied to the Russian government to stop this happening having mysteriously evaporated).

Between 2006 and the arrival of the OSP, then, there will be a gap. And the one answer that might look obvious—put the space station in mothballs and wait for the OSP—is probably not an option since the station needs regular visits from craft with rocket engines to stop its orbit decaying. Without them it might crash to earth within a year. So the shuttle will probably limp on, for this reason if no other.

None of this, of course, answers the question of why the station should continue to survive at all. Between now and the arrival of the OSP, therefore, NASA would like to get some science done on it, so as to justify its existence.

At present, with only a three-man crew aboard (due to the limited capacity of the Soyuz escape pod), this is not possible. If the budget request goes through, that will change a bit. There will be more shuttle launches to the station, and they will have science payloads on board. However, it is likely that the experiments themselves will actually be done on the shuttle—it will merely be docked to the station for an extended period while the research is carried out. On top of that, there remains the question of whether any of the science will be worthwhile. Except for research directed at making manned space-

flight easier (a pretty circular argument for justifying human-conducted experiments in space), it is hard to see the case for any human experimenters in space at all.

Both feet on the ground

Back on earth, Mr O'Keefe is also engaged in more mundane forms of cost control. Programmes are being cut. Bureaucrats, heaven forfend, are being made redundant. And he has also cast his beady eye on things that you might think NASA would be rather good at. Recently, for example, he described the agency's information-technology capabilities as “expensive, fractured, incompatible, but remarkably accessible to those who would like to use sensitive design and personnel information for personal gain.” Indeed, in August, hackers managed to steal plans for future reusable space vehicles.

There is still some way to go. Only this month, two sets of independent analysts found yet another huge budget shortfall at the space station. Depending on which of these estimates you believe, it is either $117m or $582m over the next four years. NASA is delighted. Steven Isakowitz, the agency's comptroller, remarked to *SpaceNews* that this was great news because, “they could have come back and said you're $3 billion short”. If that is thought to be progress, perhaps human space-flight is doomed after all.

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The Leonid meteors

Final curtain

Nov 14th 2002
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Night-owls may see a meteor storm on Tuesday

SHOOTING-STAR enthusiasts in Europe and North America may wish to set their alarm clocks for the early hours of November 19th. This will be the last chance for about three decades to see a Leonid meteor storm.

The Leonids are caused by debris from comet Tempel-Tuttle, which orbits the sun every 33 years. The earth crosses Tempel-Tuttle's orbit on November 18th or 19th each year, and a few meteors are usually seen. But in the years immediately after the comet has passed (which it last did in 1998) there is a lot of debris around, and thus the possibility of a natural firework display. This year is thought to be the last time that will happen until the comet's next visit in 2031.

Predictions for the display are that there will be two peaks of several thousand meteors per hour. One will be visible in Europe and North Africa for about an hour, starting at 4am GMT. The second can be seen from North America for about two hours from 5.30am EST.

Such predictions are still a bit of a black art, though they have improved over the years. Unfortunately, one thing that can be predicted with certainty is that there will be a full moon in the sky on the 19th. Since meteors are generally faint trails of light, the show will be much less spectacular than it would have been on a truly dark night.

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Theoretical physics

Publish and perish

Nov 14th 2002
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Just how rigorous is the process of scientific publication?

JOHNNY CASH once sang that he found it “very, very easy to be true”. Post-modern literary theorists find concepts of truth rather more slippery, particularly in the case of Alan Sokal. Dr Sokal is a physicist who, in 1996, submitted a deliberately nonsensical article to *Social Text*, a cultural studies journal. The article was published in a special issue on the “Science Wars”—an attempt to examine, from various perspectives, the role of science in culture. Dr Sokal, who was seeking to satirise post-modernism's chronic lack of intellectual rigour, owned up to his hoax, provoking a lively debate.

Recently, however, the boot has been on the other foot. For the past few days, physicists have been fretting that they might have been attacked by a pair of hoaxers rather like Dr Sokal. It turns out that Igor and Grichka Bogdanov, the supposed perpetrators, seem sincere in their theorising. Nonetheless, they have cast doubt on the intellectual rigour of theoretical physicists.

The Bogdanovs, who are twin brothers, have come under attack for a series of papers about a purported mathematical theory of the “singularity” at the Big Bang itself—a crucial few billionths of a second earlier than mainstream theorists generally worry about. The problem is that their mathematics do not seem to make any sense, even to other physicists.

The controversy centres on five papers published between October 2001 and April 2002. Three were written jointly by the twins, and two by Igor Bogdanov alone. These papers claimed—well, it is not clear exactly what they did claim. And therein lies the problem, for all were published in well-respected peer-reviewed journals. That means publication was conditional on the say-so of independent and anonymous expert referees. Nonsense is not supposed to get through this process—certainly not five times.

The idea that the Bogdanovs might be having the world of physics on was floated publicly by John Baez, a researcher at the University of California, Riverside. Last month he posted a message to an Internet newsgroup asking about rumours that the Bogdanovs' work was a hoax. The issue swiftly became a hot topic of discussion—with most people agreeing that there was something fishy about the papers. That the Bogdanovs might be pulling somebody's leg was not entirely implausible. Although only recently awarded their doctorates (for work related to the published papers), they are in their 50s and have had earlier careers as co-hosts of a popular science show on French television and as authors of a bestselling popular science book. Igor Bogdanov, however, reacted quickly to the claim, calling it “pure non sense”.

There is certainly no reason to doubt the brothers' denials. And the Bogdanovs continue to be supported by Daniel Sternheimer, who supervised both of their doctoral theses. But that still leaves questions about the rigour of the publication process. Neither of the two most prominent journals that published papers by the Bogdanovs, *Classical and Quantum Gravity* (*CQG*) and *Annals of Physics*, have retracted them. However, *CQG* has issued a statement saying that the paper it published “does not meet the standards expected of articles in this journal”. Hermann Nicolai, *CQG*'s editor, has also said that, as far as he can see, the article is devoid of substance. Frank Wilczek, editor of *Annals,* emphasised that he was not in charge when the Bogdanovs' paper was accepted, and he suspects that it would not have been allowed through under today's regime. He went on to say of the paper that he “had the distinct impression that one step doesn't follow from another”.

Does it matter? Perhaps not. This is not a scandal like that of Hendrik Schön, who was recently shown to have fabricated experimental results at Bell Labs in America. He worked in important and commercially significant areas of semiconductor and superconductor physics. Nonetheless, *l'affaire Bogdanov* might give post-modernists justifiable cause to snicker. And it leads you to wonder what else is getting through the supposedly foolproof net of peer review.

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Conservation and Viagra

The kindest cut of all

Nov 14th 2002
From The Economist print edition

Viagra may help to save endangered species

WELL, it looks as though we were wrong. The rules of rational behaviour seem to apply even in so irrational a field as sympathetic magic. In 1998 we wrote, in an article entitled “Why Rhinos recommend Viagra”, that “Asians do not doubt the virtues of western medicine. Many, however, assume that traditional varieties are better for certain kinds of problems, ‘vigour' among them.” In other words, we doubted that rhinos (whose horns are allegedly consumed in powdered form in the hope that they will stiffen resolve) really did have any cause to cheer. But a paper about to be published in *Environmental Conservation* suggests that they might.

The results are preliminary, but the paper's authors, Frank von Hippel, of the University of Alaska, in Anchorage, and his brother Bill, of the University of New South Wales, in Sydney, Australia, have shown that the trade in such exotica as seal penises is falling rapidly. They suspect, though they cannot yet prove, that this is because men with “vigour” problems who once placed their faith in penis soup have found that Viagra works rather better.

The brothers von Hippel looked at three products widely (and legally) traded as potency boosters: harp-seal penises, hooded-seal penises and the velvet from reindeer antlers. Between 1998—the year that Viagra went on sale—and 2000, the catch of harp seals and hooded seals in Canada (the main source of supply) plummeted. The harp-seal catch fell from about a quarter of a million (near the maximum allowed) to less than 100,000. The hooded-seal catch fell to ten, despite a permitted maximum of 10,000.

Of course, seals yield other products besides their genitalia. But as well as falling catches, there were falling prices, indicating a genuine drop in demand. Before 1998, a seal penis was worth $70-100; afterwards, only $15-20. And between 1997 and 1998, the market for antler velvet, the other commodity the brothers investigated, fell by 72%.

None of the species that formed part of the study is endangered, but some others that are traded as potency boosters, such as sea horses and certain species of sea cucumber, remain a cause for concern. And rhinos are almost extinct.

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About sponsorship

Paris

Why, oh why, do we love Paris?

Nov 14th 2002
From The Economist print edition

CORBIS

The French capital holds a special place in people's memories. Two new books explore an enduring love affair

THESE two books about Paris take very different approaches to the history of the city. Alistair Horne's account starts in pre-history, when mammoths first wandered down from the slopes of present-day Belleville; it ends in 1969, when General de Gaulle left the Elysée palace. Mr Horne, a British historical writer, likes sweeping generalisations and confident assertions. In the introduction, Maurice Druon, President Pompidou's last culture minister, calls Mr Horne's book a monument, and it does indeed pay homage to a view that is held by a certain kind of English gentleman. Paris as an ice-cream sundae—high politics and high culture topped with dash and romance.

Patrice Higonnet is more sceptical and more specialised. As current academic jargon would put it, he seeks to study metanarratives rather than construct them. Mr Higonnet is interested in myths and phantasmagorias, which he sees as more modern and more self-consciously artificial myths. He looks at how people, mainly artists and writers, came to see Paris as the capital city of artistic creation, sexual freedom, crime and alienation.

“Paris: Capital of the World” is, in many ways, an insider's account. Mr Higonnet has taught in America for most of his life, but in recent years he has become an important figure in French cultural politics. This book originated in a series of lectures he gave to that most Parisian of institutions, the Collège de France. It contains a very Parisian blend of grand theory (there are dutiful nods to Jürgen Habermas and Roland Barthes) and local gossip (he suggests that the inconvenient layout of the central Paris metro is rooted in the need to avoid running a line under the Palais Mazarin where it might have disturbed the deliberations of the Académie Française).

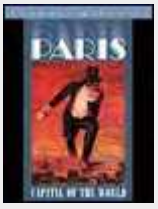
Mr Higonnet believes that, in the 20th century, Paris lost its cultural hegemony to New York, though he is sceptical about whether, in view of the opportunities offered by the Internet, any city will again enjoy that same primacy. There are

Seven Ages of Paris: Portrait of a City
By Alistair Horne

Knopf; 448 pages; $35.
Macmillan; £25

Buy it at
Amazon.com
Amazon.co.uk

Paris: Capital of the World
By Patrice Higonnet. Translated by Arthur Goldhammer



Belknap Press; 448 pages;

several problems with this argument. First, it rests on some peculiar comparisons—saying, as Mr Higonnet does, that Jackson Pollock is the equivalent of Manet is as meaningless as saying that Arnold Schwarzenegger is the equivalent of Juliette Binoche. Second, the cultural power of America in the 20th century has actually served to reinforce certain myths about Paris. As early as the 1920s, American film producers commissioned the Seeberger brothers to take photographs of what they regarded as characteristic Parisian scenes which could then be replicated on Hollywood sets. Where, except New York, would a curator put a metro station in a museum of modern art, and what restaurant could be more self-consciously Parisian than Anthony Bourdain's Les Halles in Manhattan?

$35.00

Buy it at
Amazon.com

Third, the assumption that Paris has been displaced as the cultural capital of the world looks even more questionable if we look east rather than west. Paris still represents culture, freedom and excitement to many in east and Central Europe. Writers such as Milan Kundera and Ismail Kadaré moved to the city as soon as they were released from their native lands. No film evokes the excitement that went with the opening of cold-war frontiers better than Yuri Mamin's “Window to Paris” in which the inhabitants of a St Petersburg tenement find a magic door that lets them out straight on to a Paris rooftop.

Finally, and this is a point that Mr Higonnet makes very effectively, those who grieve for a lost Paris should remember that part of the city's appeal comes precisely from the aching sense of regret for better days that it has always evoked. Those who complain that the city was ruined by Georges Pompidou and Richard Rogers in the 1970s echo those who complained in the 1930s that Baron Haussmann had ruined the city in the 1860s. Though Mr Horne might not agree, perhaps Mr Higonnet is right to suggest that the best testament to Paris is the title that Simone Signoret gave her autobiography “Nostalgia isn't what it used to be”.

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By Alistair Horne.
Knopf; 448 pages; $35.
Macmillan; £25

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Bioterror

Chariots of fear

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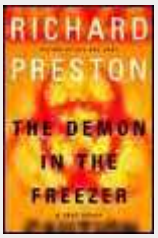
From The Economist print edition

JUST over a year ago, America discovered fear in a handful of dust. Or rather, in several envelopes of pale powder sent to east-coast newsrooms and congressional offices in Washington, DC. The powder carried microscopic spores of anthrax bacteria, specially formulated to penetrate deep into the lungs and scatter on to the skin of those unlucky enough to come in contact with these poison-pen letters.

Within weeks, five people had died, postal systems around the world were on high alert and the FBI was stuck into an extensive manhunt to find those responsible for the mail-borne mayhem. The attack was initially thought to be the work of foreign, possibly state-sponsored bioterrorists, but investigators now know that the strain of anthrax found in the envelopes was a homegrown variety, and the enclosed letters suggest that the culprit may be a lone, white male, perhaps even a disgruntled scientist. Aside from such revelations, however, progress has been frustratingly slow. No one has been charged and the public impression, at any rate, is that the trail has dried up.

The Demon in the Freezer: A True Story
By Richard Preston



Random House; 256 pages; $24.95. To be published in Britain by Headline in January 2003

Buy it at
Amazon.com

Richard Preston's account of the case, on the other hand, is anything but desiccated. “The Demon in the Freezer” is a fast-paced, gripping chronicle of the FBI's attempts to pin down the microbe murderers. Mr Preston has gone behind the scenes into the government's network of biological centres, such as USAMRIID, to reveal a world of “hot zones” and “level-4” laboratories, where researchers in protective space suits handle the world's most infectious organisms.

Mr Preston certainly knows his way round a test tube, and the book's descriptions of work in such pressure cookers are fascinating. Much of this graphic detail, such as a blow-by-blow account of an autopsy of one of the anthrax victims, adds greatly to the story, though the pile-up of other minutiae sometimes gets in the way.

This personal approach to telling a scientific story avoids the common mistake of presenting research as a dispassionate and virtually anonymous endeavour. And it probes deep into the motives, fears and personal lives of the men and women who choose this risky business. “The Demon in the Freezer” reads more like a novel than a work of non-fiction; indeed, Mr Preston's previous biomedical-bestseller, “The Hot Zone”, inspired a Hollywood film. His style is always entertaining, though occasionally confusing as the author weaves his own experience with third-party accounts in such a way as to make it hard to tell what exactly he has witnessed and what he has reconstructed.

Nonetheless, this is a book well worth reading. Its real value lies in putting today's anthrax fears into a broader and more frightening context. “The Demon in the Freezer” dwells at some length on the international biological arms race, not just Iraq's dangerous dabbling, but also the Russians' massive microbial war machine, allegedly now disbanded, but whose real status is disturbingly uncertain. The book's high points, however, are its moving account of the horrors of smallpox, the enormous efforts made by millions around the world to eradicate it, the heated debate about what to do with the remaining stocks of the virus and how to develop antidotes to the disease. “The Demon in the Freezer” is a timely reminder that nature does not need the hand of man to put nations in their place.

The Demon in the Freezer: A True Story.
By Richard Preston.
Random House; 256 pages; $24.95. To be published in Britain by Headline in January 2003

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London theatre

Alias Smith and Dench

Nov 14th 2002
From The Economist print edition

Maggie Smith and Judi Dench star together for the first time in 43 years

THE last time these two actresses appeared together in the theatre was in the late 1950s at the Old Vic, where Maggie Smith and Judi Dench—neither then yet a Dame—were part of the classical theatre company on which they founded their careers. In the intervening decades, the two women have between them won three Oscars and two Tony Awards and become international names, each one boasting a film franchise to see them into their senior years. (Dame Maggie, of course, is the beady Professor McGonagall in the Harry Potter films, while Dame Judi has carved out a distinctive niche for herself as James Bond's boss, the deliciously starchy M.)

At the same time, the theatre remains their preferred perch—Dame Judi, in particular, has long spoken of her distaste for the cinema, where one's work is frozen for all time—which is why audiences take their seats nightly at the Theatre Royal, Haymarket, in expectation of an event. And why the advance box office prior to the mid-October opening of “The Breath of Life” neared the $3m mark, far and away a West-End record for a non-musical.

Did the Dames deliver? On that subject, the verdict on Sir David Hare's play is rather more mixed than the collective response to the very real frisson of watching a two-hander in these two hands. Just as there used to be a joke within theatrical circles that one would be happy to watch the late Laurence Olivier and Anthony Quinn recite the phone book, much the same could probably be said of two seasoned veterans whose skills are so finely honed that Dame Judi, for instance, can bring a tear to the eye with the simple act of listening.

Dame Maggie was cast first, which seems self-evident given the fact that her role, a former museum curator and political firebrand, is also far more audience-friendly. Scarcely has the curtain risen on William Dudley's elegantly bohemian seaside set (the play takes place on the Isle of Wight) before the actress is peppering her remarks with the sorts of comic quips that have long been her stock in trade: one broadside about the eating habits of Americans is especially funny (and apt).

If Dame Maggie's Madeleine Palmer has willed herself into sea-bound isolation, Dame Judi's Frances Beale is a woman on the warpath—a celebrity writer with a sizeable TV following who has travelled from her London home to the Isle of Wight for a day (and, it turns out, night) of reckoning: Madeleine, we soon learn, was the long-time mistress of Frances's ex-husband, an (unseen) British lawyer called Martin who has gone on to ditch both women in favour of a young American trophy wife with whom he now lives in Seattle, Washington.

Martin figures as enough of a spectre to inflame the feminists in the audience. The point is, wouldn't two such clever and self-possessed women know enough not to define themselves by a man, particularly one whose virtues seem more and more dubious as the play proceeds across two increasingly mournful acts? But what Sir David—who has written ripe roles for women before in such plays as “Plenty” and “The Secret Rapture”—is in fact addressing is what Madeleine at one point calls “the wreck of memory” and the often painful way in which the present is forever linked to the past. To that extent, however old-fashioned “The Breath of Life” sometimes seems (the dramaturgy and, indeed, the title could have come from Ibsen), the experience of watching it tallies after a fashion with its theme. The play at heart may hark back to the emotional potboilers of a bygone age, but when you have two so memorable performers in the driver's seat, who is really going to mind?

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Keyboard jazz

Three times table

Nov 14th 2002
From The Economist print edition

The joy of jazz trios

ONE of the most familiar and popular jazz combinations is the piano trio. The prospect of a deft keyboard artist, bassist and drummer swinging through the evergreen standards has seen many a jazz fan through a hard day at the office. Yet the very success of the trio format has put creative pressure on its practitioners. How to maintain its particular strengths while expanding its expressive possibilities?

No one has tackled that challenge with more imagination and authority than Brad Mehldau. At 32 he has been hailed as “perhaps the finest pianist of his generation”, a claim substantiated by his remarkable series of recordings collectively titled “Art of the Trio”. Now running to five volumes and encompassing standards, originals, and contemporary pop, they display Mr Mehldau's glittering technique and probing intellect. In turn meditative and incisive, his solos spin out engrossing, abstract lines, while his bassist and drummer provide subtle rhythmic and harmonic counterpoint. If Mr Mehldau's approach seems too intellectual for some fans, his latest CD adopts another tack, in the direction of contemporary club culture. The tracks on “Largo” (Warner 9362-48114-2) feature a heavy, rock-style beat that evokes the world of disco, but they never lose the connection with Mr Mehldau's thoughtful, questioning spirit.

Another contemporary trio has made that kind of funky groove their trademark. The co-operative band known as Medeski, Martin and Wood have won a cult following with their live shows and Blue Note CDs. Although their keyboard player, John Medeski, is an excellent pianist, he usually plays the Hammond organ, an instrument redolent of sweaty soul and heaving dance floors. Conjuring that louche atmosphere is the trio's speciality, along with quirky humour and spacey electronic effects. Their latest CD, “Uninvisible” (Blue Note 7243-5-35870-2-4), also adds horns, a guitar and vocals, revelling in such grungy originals as “I Wanna Ride You”, “Nocturnal Transmission”, and a bizarre stream-of-consciousness tale of life on the road called “Your Name is Snake Anthony”.

One of the first jazz artists to cross-fertilise jazz and rock was a vibraphonist, Gary Burton, and he is still spearheading new directions, albeit of a different sort. He and his long-term partner, Makoto Ozone, a highly-regarded Japanese pianist, recently demonstrated that the old dream of amalgamating jazz and classical music can still yield stunning results. Their CD, “Virtuosi” (Concord Jazz CCD-2105-2), comprising versions of pieces by the likes of Ravel, Scarlatti, Gershwin, Rachmaninov and Brahms, is not a cheesy exercise in “jazzing the classics”, but two superb musicians bringing a new creative dimension to material they respect deeply. Each track combines a felicitous arrangement of the original work, followed by brilliant improvisations that extend its potential. Mr Burton and Mr Ozone are virtuosi indeed, and their scintillating interpretations will delight both jazz and classical listeners. What's more, they just might have some influence on what you hear next time you visit your local jazz club.

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New French fiction

Pop goes the author

Nov 14th 2002
From The Economist print edition

IN FRANCE, as elsewhere, the literary row is a valuable tool in the publicity kit for the promotion of book prizes. When Pascal Quignard won this year's Prix Goncourt for “Les Ombres Errantes”, several Paris critics complained of an elitist choice, grumbling that this was less a novel than an obscure and unreadable commonplace book. Others scoffed that the winning entry was what passes for experimental fiction among middlebrows.

You need not plunge deep into this quarrel to agree that there were highly readable alternatives among the non-winners. Two in particular stand out, both of them original works of fiction that re-examine icons of popular mythology.

Yann Moix's “Podium” is a sparkling and very funny account of the life of Bernard Frédéric, a man who has devoted his existence to performing in provincial halls as an impersonator of Claude François, a diminutive French pop idol who was found electrocuted in his bath in 1978. Mr Moix takes the reader into the world of popular-entertainment imitators, where ordinary people enjoy vicarious fame against a backdrop of suburban parking lots and village agricultural festivals. Some reviewers have taken “Podium” as a meaningful statement about the nature of fame, the power of the media and our yen for a Warholian instant of celebrity. Yet the novel is anything but a work of sociology. Cleverly dressed up as a fictional investigation of personal identity, “Podium” is above all supremely comic.

Bernard's story is told by his friend, admirer and road manager, Couscous, himself a former Claude François impersonator who hung up his own wig and flared trousers when confronted by the superior mastery of Bernard's act. Bernard himself is a magnificent comic creation: a monster of egotism and stupefying miserliness, whose justification for his excesses is that he has sublimated himself into the reincarnation of his idol: he is almost more Claude than Claude François himself.

Podium
By Yann Moix

Grasset; 291 pages; euro20

Buy it at Amazon.fr

Tigre en Papier
By Olivier Rolin

Seuil; 272 pages; euro18

Buy it at Amazon.fr

The stylistic skill of the novel lies in the creation of a permanent tension between the burlesque excesses—as a comic set-piece, the karaoke contest in a provincial pizzeria is well worth a place in an anthology of contemporary humorous writing—and the studious, deadpan seriousness with which Mr Moix describes the obsessions of his characters. This is humour in the tradition of Alphonse Allais or Raymond Queneau.

Olivier Rolin's “Tigre en Papier” scrutinises icons of a different kind. A former *enfant terrible* of a Maoist group, Nouvelle Résistance Populaire, Mr Rolin took part in a wave of underground violence until the movement was disbanded in 1973, whereupon he disappeared for many years. On re-emergence, he turned, with success, to fiction, winning the Prix Fémina in 1994 for “Port-Soudan”, which recounts the return to France of a left-wing militant after a 20-year exile. Now Mr Rolin confronts and exorcises past demons in a work that is, in effect, an extended and elegiac prose-poem.

In the early hours of the morning, an old Citroën DS drives endlessly around the Paris Boulevard Périphérique. On board are Martin, the narrator, Mr Rolin's alter ego, and the 20-something daughter of a long-dead companion-in-arms from Martin's Maoist days. Now in his 50s, Martin has reached “the prophylactic age; the age of work-outs in the gym and check-ups of the colon”. As night progresses and dawn breaks, Martin revisits his life with ironic detachment, telling Marie of the father she has never

known. In doing so, as he watches the neon advertising messages slide past the windscreen, he unwittingly underlines the chasm between the passion and commitment of his own youth and the seemingly uncommitted, materialistic spirit of the generation represented by his late friend's daughter.

The novel takes us on a tour of a generation and its myths: Mao, Che, Vietnam (where we follow a search for the memory of the dead father of the narrator-author), the B-52 bomber, Pompidou (“le président Pompe”), Beirut. With little respect for the logic of time, the prose reads like the fractured, haunted narrative of a man who has looked deeply into himself and been changed by the experience. Mr Rolin quite possibly has a great novel in him. In the meantime, this one will do very well.

“Podium” refracts the trivia of pop culture through the prism of an observant, trenchant humour. Mr Rolin filters his experience through the ironic lens of a melancholy self-awareness. Each view of the past brings its different rewards.

Podium.
By Yann Moix.
Grasset; 291 pages; euro20

Tigre en Papier.
By Olivier Rolin.
Seuil; 272 pages; euro18

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About sponsorship

Bestsellers in America and Britain

What the world is reading

Nov 14th 2002
From The Economist print edition

Human potential and bossy boots

AMERICANS love strong men, but for the British nothing beats a good beating. With his heartfelt homilies and homespun wisdom, Rudolph Giuliani (“Leadership”) looks set for full-time residence on the American bestseller lists alongside Bob Greene (“Get with the Program!”) and Spencer Johnson (“Who Moved My Cheese?”). But if it's more chicken soup in your wallet that you want, then reach for Mark Victor Hansen (“The One Minute Millionaire”).

In Britain, the nannies rule. Trinny Woodall and Susannah Constantine (“What Not to Wear”) are the queens of the closet, though what they really like is chucking all your favourite things into the bin. In the kitchen it's Delia Smith (“Delia's Vegetarian Collection”) whipping up green, green and more greens. “Honest” Ulrika Jonsson bucks the trend, but then she's Swedish.

All in all, it's enough to make you turn to fiction. Yann Martel (“Life of Pi”), Donna Tartt (“The Little Friend”) and Minette Walters (“Fox Evil”) have all leapt into the bestseller list to join Alice Sebold (“The Lovely Bones”) and Maeve Binchey (“Quentins”). Though with all the stresses of the holiday season still to come, “Skipping Christmas” in the company of John Grisham may be what you're really dreaming of.

Bestsellers

	AMERICAN FICTION	AMERICAN NON-FICTION
1	**The Lovely Bones** *by Alice Sebold* The view from on high	**Leadership** *by Rudolph Giuliani* Former mayor's hands-on advice
2	**Answered Prayers** *by Danielle Steel* Manhattan housewife questions life	**My Losing Season** *by Pat Conroy* Strength from suffering
3	**Blackwood Farm** *by Anne Rice* Gripping Gothic yarn	**Get with the Program!** *by Bob Greene* Reach your physical and mental potential
4	**Q is for Quarry** *by Sue Grafton* Kinsey Millhone's 17th quest	**Who Moved My Cheese?** *by Spencer Johnson* Million-selling self-help fable
5	**Reversible Errors** *by Scott Turow* Death-row killer thriller	**Good to Great** *by Jim Collins* How companies improve
6	**Quentins** *by Maeve Binchy* Dublin restaurant saga	**The One Minute Millionaire** *by Mark Victor Hansen and Robert G. Allen* The secrets of making money
7	**Esther's Gift** *by Jan Karon* The meaning of giving	**Let Freedom Ring** *by Sean Hannity* Talk-show host's view of the world
8	**Skipping Christmas** *by John Grisham* The tyranny of December 25th	**Rich Dad's Prophecy** *by Robert T. Kiyosaki* Survival instructions for investors
9	**Nights in Rodanthe** *by Nicholas Sparks* Secret affair with a stranger	**Longitudes and Attitudes** *by Thomas L. Friedman* September 11th and its aftermath
10	**Chasing the Dime** *by Michael Connelly* A phone call triggers trouble	**Live from New York** *by Tom Shales and James Andrew Miller* NBC's "Saturday Night Live" exposed

	BRITISH FICTION	BRITISH NON-FICTION
1	**Night Watch** *by Terry Pratchett* The 27th Discworld offering	**Guinness World Records: 2003** *Edited by Claire Folkard* The latest record-breakers
2	**Maura's Game** *by Martina Cole* East End violence and corruption	**What Not to Wear** *by Trinny Woodall and Susannah Constantine* Advice from bossy fashionistas
3	**Life of Pi** *by Yann Martel* In a lifeboat with a Bengal tiger	**Sahara** *by Michael Palin* Former Python's desert journey
4	**Just Between Us** *by Cathy Kelly* Three women find fulfilment	**Unless I'm Very Much Mistaken** *by Murray Walker* The voice of Formula 1 tells all
5	**The Little Friend** *by Donna Tartt* Avenging a brother's death	**Delia's Vegetarian Collection** *by Delia Smith* Eating well without meat or fish
6	**Quentins** *by Maeve Binchy* Dublin restaurant saga	**Jamie's Kitchen** *by Jamie Oliver* Pukka tucker and trainee chefs
7	**Liberation Day** *by Andy McNab* More war from former SAS soldier	**Keane: The Autobiography** *by Roy Keane and Eamon Dunphy* Controversial footballer's memoirs
8	**Four Blind Mice** *by James Patterson* Rollercoaster suspense and murder	**Gareth Gates: Right from the Start** *by Gareth Gates and Sian Solanas* "Pop Idol" loser's story
9	**Fox Evil** *by Minette Walters* A community at war	**Honest** *by Ulrika Jonsson* Facing up to past mistakes
10	**Vagabond** *by Bernard Cornwell* The second Grail Quest novel	**Oor Wullie: 2003** *Published by D.C. Thomson* Cartoon rascal makes mischief

Sources: *Publishers Weekly; Nielsen BookScan* Descriptions by *The Economist*

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About sponsorship

René Thom

Nov 14th 2002
From The Economist print edition

René Thom, inventor of catastrophe theory, died on October 25th, aged 79

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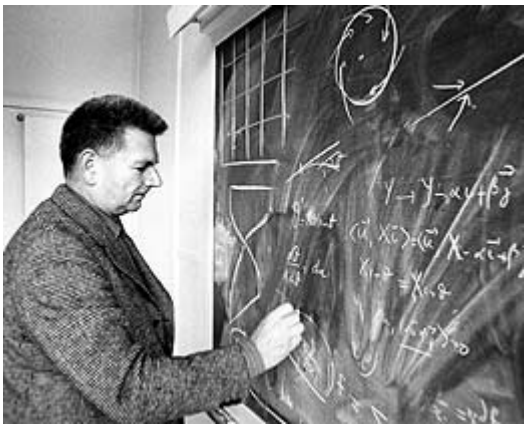

GREAT things were expected from René Thom's catastrophe theory when it first emerged in the 1970s from the arcane deliberations of mathematicians into the everyday world of people who just hope for a more ordered life. Mr Thom did his best to make his theory sound simple. Take the example of a river, he said. It flows along smoothly and predictably until it turns suddenly into a catastrophic waterfall. Salvador Dali, in what he said was “homage” to Mr Thom, helpfully painted a picture of a landscape of smooth hills with a crack running through them, and added a formula for viewers with a mathematical turn of mind.

Put slightly more technically, Mr Thom defined catastrophe as the loss of stability in a dynamic system. Catastrophes are inevitable, but obviously their damage could be lessened if they could be predicted. Could Mr Thom's theory be applied, say, to the safety of buildings or of ships at sea; to riots; to strikes; to when a tyrant leader would lose control and become vulnerable? The world of finance, alternately in a state of cockeyed optimism and deep gloom, was very interested in the theory. Mr Thom was slightly taken aback by being associated with astrologers, the apocalypse and UFOs, but he referred those interested to his book, “Structural Stability and Morphogenesis”, which briefly became a bestseller.

It is full of ideas, many of which are only marginally related to mathematics. He claims, for example, that men are physically more fragile than women; women are more rounded, closer to the sphere, the strongest shape in the universe. Maths-type symbols, he said, are recognised by animals: a tiger could spot a gazelle's hoof-prints. In this sense the animal could read.

Down in the forest

But the book was less an offering of easily-digested novelties, than a mathematical treatise dealing with the seven ways in which things are likely to collapse suddenly. It is no reflection on the intelligence of many people who tackled the book that they found it baffling. In the 19th century, a mathematician such as Henri Poincaré, a compatriot of Mr Thom, could claim to understand all the important maths of his time. This would have been a rare claim in the 1970s, and rarer still today. Popular interest in catastrophe theory lasted for about 20 years; not bad as ideas go. It waned when it seemed to offer no obvious material gain, and returned to the specialised area from which it came. “All good minds”, Mr Thom said, a touch bitterly, in later life, “decided that it was of no value.” One of the theory's few practical applications was to decide how to save forests from the catastrophic spruce budworm. The answer provided by Mr Thom's maths was to chop down old trees, which foresters said they knew anyway.

Mr Thom's theory may have been treated unfairly. It was philosophical as much as mathematical. The theory continues to be cited occasionally in discussions of how catastrophes have suddenly intervened to reshape history. Mr Thom was keen to explain how the theory worked in the history of his own country. The French revolution was the big bang of catastrophe theory, he said, and its effects had not yet been exhausted.

One of its effects, he said, was the second world war, a catastrophe for France, and for René's parents who ran a shop in Montbéliard in eastern France. In 1940, when the Germans invaded, René, then 16, joined the refugees fleeing south. Like many French of his generation he was appalled by France's quick

defeat, but was equally defensive of France's greatness. Any criticism of his work he disparagingly called “Anglo-Saxon”.

The young René made his way to Switzerland but then returned to France, settling for a time in Lyons, where he resumed his education. He gained entry to the Ecole Normale Supérieure, in Paris, which then as now sought only the most brilliant of students. After gaining a doctorate in mathematics Mr Thom taught at various universities in France. He was awarded grants to visit the United States in 1951, where he talked physics with the ageing Albert Einstein.

He won the applause of his peers with his work on cobordism, a branch of maths that involves algebra and geometry. In 1958 he was awarded the Fields medal, named after J.C. Fields, a Canadian mathematician, which has something of the standing of a Nobel. The judges spoke of “the grand simplicity” of Mr Thom's ideas. He published a paper on catastrophe theory in 1968, and his seminal book four years later.

What is a catastrophe? Some commentators on Mr Thom's work question whether the momentous events of history can really be called catastrophes, using the word in the sense that they were totally unexpected interruptions of an ordered existence. Even the supine French court sensed that something nasty was happening in Paris in the 1780s. Followers of Mr Thom claim that the fall of the Berlin Wall in 1989 was unexpected, although only the timing was a surprise. Such events did have unimagined consequences: the emergence of Napoleon; the sudden break-up of the Soviet Union. But they can be accounted for by chaos theory, which is another matter altogether.

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Overview

Nov 14th 2002
From The Economist print edition

The Fed's half-point rate cut made little impact on the world's mostly depressed **stockmarkets**, though an apparently reduced threat of immediate war against Iraq revived some investors' spirits.

Japan's recovery is showing signs of slowing. GDP grew by only 0.7% in the third quarter, down from 1.0% in the previous quarter. In year-on-year terms, GDP grew by 1.5% in the year to the third quarter, its first gain after four quarters of decline. Consumer demand is sliding: retail sales fell by 1.9% in the year to September, compared with a 1.3% fall in the year to August. The deteriorating outlook sent the Nikkei 225 stockmarket average to its lowest in nearly 20 years.

Japanese producer prices rose by 0.3% in the year to October, the first year-on-year rise in 14 months. Japan's broad-money growth edged up to 3.3% in the year to October, up from 3.2% in the year to September.

Unemployment in **Britain** rose to 5.3% in the period from July to September, up from 5.2% in the June to August period. The more reliable claimant-count measure, however, was stable at 3.1% for the fourth successive month. Consumer-price inflation rose to 2.1% in the year to October, from 1.7% in the year to September; producer prices rose by 0.6% in the year to October. Britain's trade deficit widened to $46.1 billion in the year to September, compared with $45.1 billion in the year to August.

The European Commission cut its forecast for growth in the **euro area**. It now expects GDP growth in 2003 of just 1.8%, down from its earlier forecast of 2.9%, with most of the growth coming in the second half of the year. **Germany's** manufacturing slump continues; industrial production, which has been falling year-on-year for 15 months running, fell by 1.3% in the year to September. In another sign of weakness, German producer prices are dropping again, falling by 0.2% in October. Germany's current-account surplus widened to $37.6 billion in the year to September, from $31.3 billion in the year to August.

Canada's unemployment rate was 7.6% in October, down from 7.7% in September.

Sweden's shoppers have become busier. Retail sales grew by 7.4% in the year to September, compared with 2.1% growth in the year to August.

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Output, demand and jobs

Nov 14th 2002
From The Economist print edition

% change on year ago

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr*	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 2.4	+ 3.8 Q2	+ 3.7	+ 3.5	+ 2.7 Q2	+ 5.4 Q3	6.0 Oct	7.0
Austria	na	+ 0.4 Q2	+ 0.7	+ 1.7	− 1.4 Aug	+ 2.7 Jul	4.2 Sep	3.7
Belgium	+ 1.2	+ 0.3 Q2	+ 0.6	+ 1.8	+ 2.8 Aug	− 0.9 Aug	11.9 Oct†	11.5
Britain	+ 2.7	+ 1.7 Q3	+ 1.6	+ 2.6	− 2.5 Sep	+ 4.6 Sep	5.3 Sep‡	5.1
Canada	+ 4.3	+ 3.2 Q2	+ 3.4	+ 3.2	+ 3.1 Aug	+ 5.2 Aug	7.6 Oct	7.4
Denmark	+ 4.4	+ 2.0 Q2	+ 1.8	+ 2.1	nil Sep	+ 3.4 Aug	5.3 Sep	5.1
France	+ 1.6	+ 1.0 Q2	+ 1.1	+ 1.8	− 1.1 Aug	− 1.5 Sep	9.0 Sep††	8.7
Germany	+ 1.1	+ 0.1 Q2	+ 0.4	+ 1.3	− 1.3 Sep	− 1.3 Sep	9.9 Oct§	9.5
Italy	+ 1.1	+ 0.5 Q3	+ 0.4	+ 1.6	+ 1.2 Sep	− 1.4 Aug	9.0 Jul	9.5
Japan	+ 3.0	+ 1.5 Q3	− 0.7	+ 1.0	+ 5.2 Sep	− 1.9 Sep	5.4 Sep	5.3
Netherlands	+ 0.3	+ 0.1 Q3	+ 0.4	+ 1.4	− 2.3 Sep	+ 2.0 Aug	2.3 Sep**	2.0
Spain	+ 1.8	+ 2.0 Q2	+ 1.9	+ 2.4	+ 3.1 Sep	na	11.2 Sep	10.6
Sweden	+ 2.4	+ 2.1 Q2	+ 1.7	+ 2.4	− 0.4 Aug	+ 7.4 Sep	4.2 Sep†	4.0
Switzerland	+ 0.4	− 0.4 Q2	+ 0.1	+ 1.3	− 2.0 Q2	− 1.1 Sep	3.0 Oct†	1.9
United States	+ 3.1	+ 3.0 Q3	+ 2.4	+ 2.7	+ 1.5 Sep	+ 7.6 Sep	5.7 Oct†	5.4
Euro area	+ 1.6	+ 0.7 Q2	+ 0.7	+ 1.7	− 0.8 Aug	+ 1.5 Aug	8.3 Sep	8.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 8.8	+ 2.5 Q2	na	na	+ 0.8 Sep	+ 1.2 Jul	8.1 Sep†	8.7
Greece	na	+ 4.0 Q2	na	na	− 1.4 Sep	na	na	na
Iceland	na	+ 3.12001	na	na	+ 3.3 2001	na	2.2 Sep†	1.0
Ireland	na	+ 6.5 Q2	na	na	+ 8.2 Sep	+ 1.2 Aug	4.3 Oct	3.9
Luxembourg	na	+ 3.52001	na	na	− 1.9 Aug	− 0.9 Jun	3.0 Sep†	2.5
New Zealand	+ 7.1	+ 4.0 Q2	na	na	+ 4.3 Q2	+ 8.3 Q2	5.4 Q3	5.2
Norway	+ 3.1	+ 1.7 Q2	na	na	−10.1 Sep	+ 4.3 Sep	3.8 Q3	3.6
Portugal	+ 2.8	+ 0.9 Q2	na	na	+ 0.1 Sep	+ 1.9 Sep	4.5 Q2†	3.9

*% change at an annual rate. †Not seasonally adjusted. ††July-Sep; claimant count rate 3.1% in Oct. §EU harmonised rate 8.3% in Sep. **Jul-Sep.

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Prices and wages

Nov 14th 2002
From The Economist print edition

% change on year ago

	Consumer prices latest		Consumer prices year ago	The Economist poll consumer prices forecast 2002	The Economist poll consumer prices forecast 2003	Producer prices latest		Producer prices year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 3.2	Q3	+ 2.5	+ 2.8	+ 2.5	– 0.2	Q3	+ 2.4	+ 3.7	Q2	+ 4.4
Austria	+ 1.6	Sep	+ 2.6	+ 1.8	+ 1.7	+ 0.3	Oct	– 0.5	+ 2.3	Sep	+ 2.9
Belgium	+ 1.3	Oct	+ 2.4	+ 1.7	+ 1.4	+ 0.8	Sep	– 2.5	+ 2.1	Q3	+ 3.7
Britain	+ 2.1	Oct	+ 1.6	+ 1.9	+ 2.4	+ 0.6	Oct	– 0.6	+ 3.8	Sep	+ 4.3
Canada	+ 2.3	Sep	+ 2.6	+ 2.2	+ 2.5	+ 0.5	Sep	+ 1.0	+ 2.8	Aug	+ 1.4
Denmark	+ 2.5	Oct	+ 2.2	+ 2.3	+ 2.1	– 0.3	Sep	+ 0.7	+ 3.7	Q2	+ 4.7
France	+ 1.9	Oct	+ 1.8	+ 1.9	+ 1.4	+ 0.3	Sep	– 0.2	+ 3.8	Q2	+ 4.2
Germany	+ 1.3	Oct	+ 2.0	+ 1.4	+ 1.2	+ 0.9	Oct	– 1.1	+ 2.7	Aug	+ 1.9
Italy	+ 2.7	Oct	+ 2.5	+ 2.4	+ 1.9	+ 0.5	Sep	+ 0.4	+ 2.5	Sep	+ 2.4
Japan	– 0.7	Sep	– 0.8	– 0.9	– 0.6	+ 0.3	Oct	– 0.6	+ 1.7	Sep	– 0.5
Netherlands	+ 3.4	Oct	+ 4.3	+ 3.7	+ 2.5	+ 0.6	Sep	+ 0.7	+ 3.4	Sep	+ 4.7
Spain	+ 1.0	Oct	+ 3.0	+ 3.4	+ 2.6	+ 1.1	Sep	+ 0.6	+ 4.0	Q2	+ 2.9
Sweden	+ 2.5	Oct	+ 2.7	+ 2.3	+ 2.1	– 0.3	Sep	+ 1.1	+ 2.7	Aug	+ 3.6
Switzerland	+ 1.3	Oct	+ 0.6	+ 0.7	+ 0.9	– 0.6	Oct	– 1.4	+ 2.5	2001	+ 1.3
United States	+ 1.5	Sep	+ 2.6	+ 1.6	+ 2.2	– 1.9	Sep	+ 1.6	+ 3.0	Oct	+ 3.8
Euro area	+ 2.2	Oct	+ 2.3	+ 2.2	+ 1.7	+ 0.1	Sep	+ 0.7	+ 3.3	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.5	Oct	+ 2.2	na	na	– 0.8	Sep	– 2.1	+ 3.8	Q2	+ 4.9
Greece	+ 3.7	Oct	+ 2.8	na	na	+ 1.9	Sep	+ 1.3	na		na
Iceland	+ 2.4	Nov	+ 8.1	na	na	+ 5.9	Oct	+ 6.8	+ 5.8	Sep	+ 9.1
Ireland	+ 4.7	Oct	+ 4.3	na	na	+ 0.3	Sep	– 0.3	+ 4.3	Q2	+ 8.5
Luxembourg	+ 2.0	Sep	+ 2.4	na	na	– 0.3	Aug	– 0.4	– 1.8	Aug	+ 3.4
New Zealand	+ 2.6	Q3	+ 2.4	na	na	+ 1.5	Q2	+ 8.1	+ 2.3	Q3	+ 2.0
Norway	+ 1.8	Oct	+ 2.2	na	na	+ 4.4	Oct	–19.1	+ 4.9	Q2	+ 4.4
Portugal	+ 3.7	Sep	+ 4.0	na	na	+ 0.1	Sep*	na	– 2.6	Jul	– 1.2

*Revised series.

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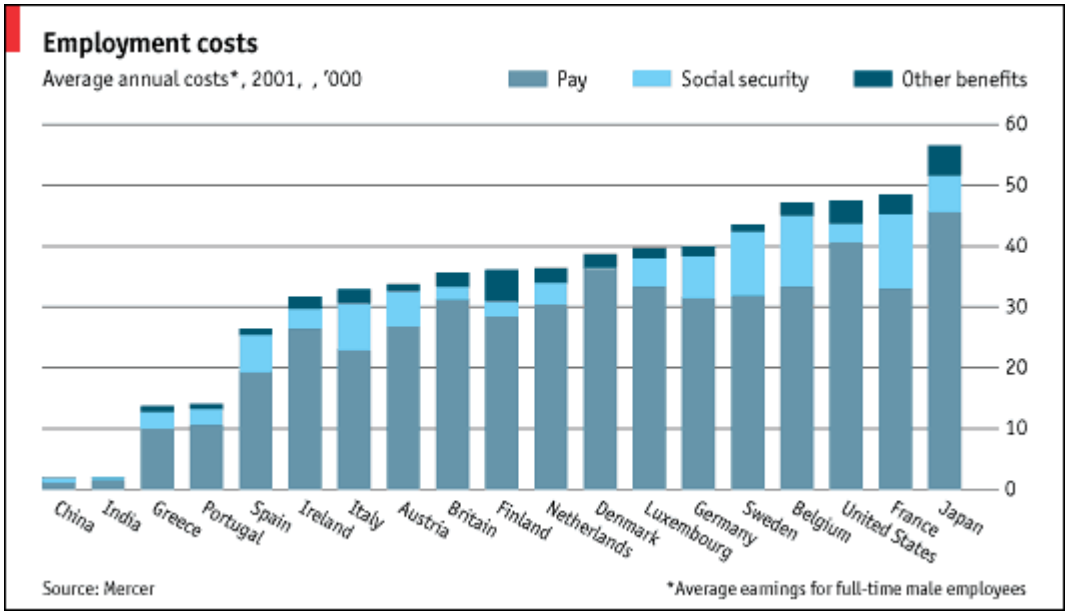
Employment costs

Nov 14th 2002
From The Economist print edition



The total cost of employing workers in Japan and America dwarfs that of southern Europeans, according to Mercer, a consultancy. Employment costs in the EU are 35% below those in America, and a massive 60% lower than in Japan. Within Europe, however, big differences persist. Employment costs in France, thanks to huge social-security and benefit charges, are nearly four times higher than in Greece.

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Money and interest rates

Nov 14th 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 13th 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	– 6.1	+11.4	Sep	4.80	4.29	4.60	5.28	5.25	6.38
Britain	+ 8.2	+ 5.4	Sep	3.94	3.81	3.74	4.49	4.52	5.78
Canada	+14.7	+ 6.6	Sep	2.69	2.21	3.21	5.00	5.10	7.09
Denmark	+ 7.4	+ 8.1	Sep	3.35	3.75	3.39	4.54	4.61	6.78
Japan	+29.0	+ 3.3	Oct	0.02	0.02	0.04	0.97	1.33	1.05
Sweden	+ 2.2	+ 5.9	Jul	3.94	3.74	3.95	4.88	4.88	4.61
Switzerland	+12.3	+ 6.8	Sep	0.70	2.05	0.54	2.43	3.04	3.75
United States	– 0.6	+ 6.5	Sep	1.31	1.90	1.74	3.83	4.52	6.27
Euro area†	+ 8.2	+ 7.4	Sep	3.14	3.34	3.00	4.36	4.41	5.29

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.79%, Japan No.243 0.95%. Central bank rates: US fed funds 1.25%, ECB refinancing 3.25%, BOJ overnight call 0.002%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Nov 14th 2002
From The Economist print edition

1995=100

	Nov 5th	Nov 12th*	% change on one month	% change on one year
Dollar index				
All items	76.2	75.8	+ 0.2	+17.5
Food	80.3	79.7	– 1.3	+18.7
Industrials				
All	70.5	70.6	+ 2.6	+15.6
Nfa†	72.4	72.2	– 0.4	+25.5
Metals	69.0	69.3	+ 5.4	+ 8.2
Sterling index				
All items	76.9	75.3	– 1.9	+ 6.8
Euro index				
All items	100.1	98.8	– 2.5	+ 2.6
Yen index				
All items	98.8	96.2	– 4.3	+15.3
Gold				
$ per oz	318.35	321.65	+ 1.9	+16.0
West Texas Intermediate				
$ per barrel	26.09	25.94	–12.9	+19.1

* Provisional. † Non-food agriculturals.

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Stockmarkets

Nov 14th 2002
From The Economist print edition

Market indices

	Nov 13th	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	2,932.2	3,440.0	2,855.5	- 3.4	-14.8	-12.7	- 4.6
Austria (ATX)	1,098.3	1,357.2	1,003.7	+ 0.3	-36.8	- 3.7	+ 9.1
Belgium (Bel 20)	1,962.9	2,899.8	1,773.7	- 3.4	-46.7	-29.4	-20.1
Britain (FTSE 100)	4,029.4	5,323.8	3,671.1	- 1.8	-41.9	-22.8	-15.8
Canada (Toronto Composite)	6,301.8	7,958.1	5,695.3	- 2.1	-44.7	-18.0	-17.1
Denmark (KBX)	166.0	233.4	156.4	- 2.5	-45.0	-26.2	-16.3
France (SBF 250)	2,042.2	3,081.9	1,794.5	- 5.0	-53.5	-31.5	-22.4
(CAC 40)	3,034.8	4,688.0	2,656.5	- 5.5	-56.2	-34.4	-25.7
Germany (Xetra DAX)	3,066.4	5,462.6	2,597.9	- 7.1	-62.0	-40.6	-32.7
Italy (BCI)	1,080.3	1,513.0	974.4	- 4.6	-50.5	-24.6	-14.6
Japan (Nikkei 225)	8,438.5	11,979.9	8,438.5	- 5.7	-78.3	-20.0	-12.7
(Topix)	836.4	1,139.4	835.6	- 5.3	-71.0	-19.0	-11.6
Netherlands (AEX)	326.2	531.2	291.4	- 6.6	-53.5	-35.6	-27.1
Spain (Madrid SE)	642.7	848.1	568.5	- 2.6	-43.9	-22.0	-11.7
Sweden (Affarsvarlden Gen)	153.7	236.8	122.7	+ 1.0	-61.6	-33.6	-22.4
Switzerland (Swiss Market)	4,832.3	6,694.1	4,435.0	- 3.6	-42.6	-24.7	-13.9
United States (DJIA)	8,398.5	10,635.3	7,286.8	- 4.2	-28.4	-16.2	-16.2
(S&P 500)	882.5	1,172.5	776.8	- 4.5	-42.2	-23.1	-23.1
(NASDAQ Comp)	1,361.3	2,059.4	1,114.1	- 4.1	-73.0	-30.2	-30.2
Europe (FTSE Eurotop 300)*	883.8	1,279.7	797.2	- 3.2	-48.2	-29.9	-20.6
Euro area (FTSE Ebloc 100)*	729.9	1,125.1	639.4	- 5.1	-52.9	-34.4	-25.6
World (MSCI)†	789.4	1,024.4	703.7	- 3.7	-45.5	na	-21.3
World bond market (Salomon)‡	509.1	510.0	430.3	+ 1.8	+ 1.0	na	+15.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Nov 14th 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account % of GDP, forecast 2002	Current account % of GDP, forecast 2003	Exchange rate trade-weighted† 1990=100 Nov 13th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Nov 13th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2002‡
Australia	– 2.7	Sep	– 11.6	Q2	– 3.7	– 3.7	73.9	72.6	1.79	1.93	2.83	1.80	1.49	0.1
Austria	– 1.1	Jul	– 1.0	Aug	– 1.8	– 1.8	100.8§	100.3	0.99	1.13	1.57	–	0.83	-0.3
Belgium	+ 16.6	Aug	+ 12.5	Jun	+ 4.9	+ 5.0	100.0§	99.2	0.99	1.13	1.57	–	0.83	nil
Britain	– 46.1	Sep	– 25.8	Q2	– 1.9	– 1.9	106.2	107.0	0.63	0.69	–	0.64	0.52	-0.8
Canada	+ 34.3	Aug	+ 12.1	Q2	+ 2.0	+ 2.1	75.0	75.5	1.58	1.59	2.50	1.59	1.31	1.0
Denmark	+ 7.1	Sep	+ 3.6	Sep	+ 2.2	+ 2.0	103.2	101.8	7.36	8.42	11.7	7.43	6.13	2.2
France	+ 9.8	Sep	+ 27.6	Aug	+ 1.8	+ 1.8	102.9§	101.9	0.99	1.13	1.57	–	0.83	-2.0
Germany	+110.9	Sep	+ 37.6	Sep	+ 1.4	+ 1.0	99.9§	98.7	0.99	1.13	1.57	–	0.83	-2.8
Italy	+ 14.1	Aug	– 3.1	Jul	nil	nil	73.4§	72.7	0.99	1.13	1.57	–	0.83	-1.4
Japan	+ 86.5	Sep	+113.1	Sep	+ 2.8	+ 2.8	133.3	139.2	120	122	191	121	–	-8.0
Netherlands	+ 27.2	Sep	+ 2.7	Q2	+ 3.3	+ 3.6	99.1§	98.1	0.99	1.13	1.57	–	0.83	0.1
Spain	– 36.4	Aug	– 14.5	Jul	– 1.9	– 1.7	75.0§	74.3	0.99	1.13	1.57	–	0.83	-0.3
Sweden	+ 14.3	Sep	+ 8.0	Sep	+ 3.3	+ 3.3	78.5	74.3	8.98	10.6	14.2	9.06	7.48	2.1
Switzerland	+ 3.8	Sep	+ 22.7	Q2	+10.0	+10.3	114.9	111.8	1.45	1.66	2.30	1.46	1.21	na
United States	–446.5	Aug	–428.8	Q2	– 4.7	– 4.9	112.5	119.8	–	–	1.59	1.01	0.83	-1.0
Euro area	+ 89.5	Aug	+ 31.6	Aug	+ 0.5	+ 0.6	82.6	77.7	0.99	1.13	1.57	–	0.83	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.0	Aug	+ 9.5	Sep	na	na	79.0§	78.9	1.00	1.13	1.59	–	0.83	3.2
Greece	– 18.4	Jul	– 7.7	Aug	na	na	58.0§	57.6	1.00	1.13	1.59	–	0.83	0.4
Iceland	+ 0.2	Sep	– 0.1	Q2	na	na	93.0**	87.8	87.1	107.1	138	87.9	72.5	-0.5
Ireland	+ 34.2	Aug	+ 0.4	Q2	na	na	89.1§	87.7	1.00	1.13	1.59	–	0.83	0.1
Luxembourg	– 2.6	Aug	+ 2.1	Q2	na	na	100.0§	99.2	1.00	1.13	1.59	–	0.83	2.2
New Zealand	– 0.2	Sep	– 1.3	Q2	na	na	89.4	80.1	2.02	2.37	3.21	2.04	1.68	0.1
Norway	+ 24.5	Sep	+ 25.6	Aug	na	na	106.4	97.3	7.39	8.89	11.7	7.45	6.15	14.0
Portugal	– 12.8	Jul	– 9.4	Jul	na	na	91.2**	89.5	1.00	1.13	1.59	–	0.83	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

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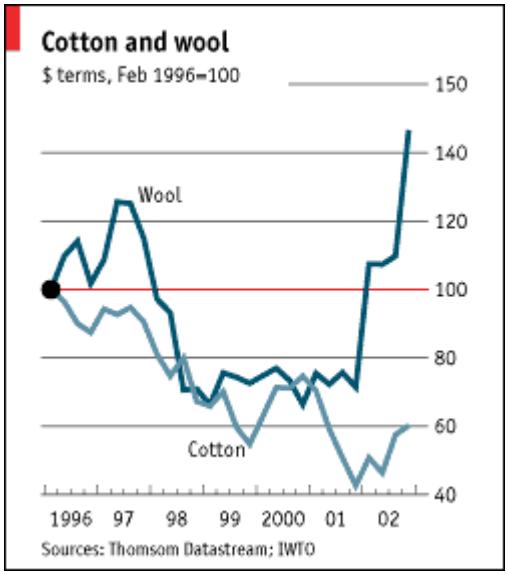
Cotton and wool

Nov 14th 2002
From The Economist print edition

Wool production in Australia has hit record lows, sending prices to a 15-year high. Cotton prices, which recently slumped to a three-decade low, have started rising again.



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Overview

Nov 14th 2002
From The Economist print edition

China's economy continues to look surprisingly strong. Industrial production in the 12 months to October rose by 14.2%, faster than forecast. Boosted by strong export growth, China's monthly trade surplus doubled to $4.75 billion in October, raising the 12-month trade surplus to $30.0 billion.

Inflation is creeping up in **Latin America**. Consumer prices in **Venezuela** rose by 29.9% in the year to October. In **Brazil**, consumer prices rose by 8.5% in the year to October, up from 7.9% in the year to September.

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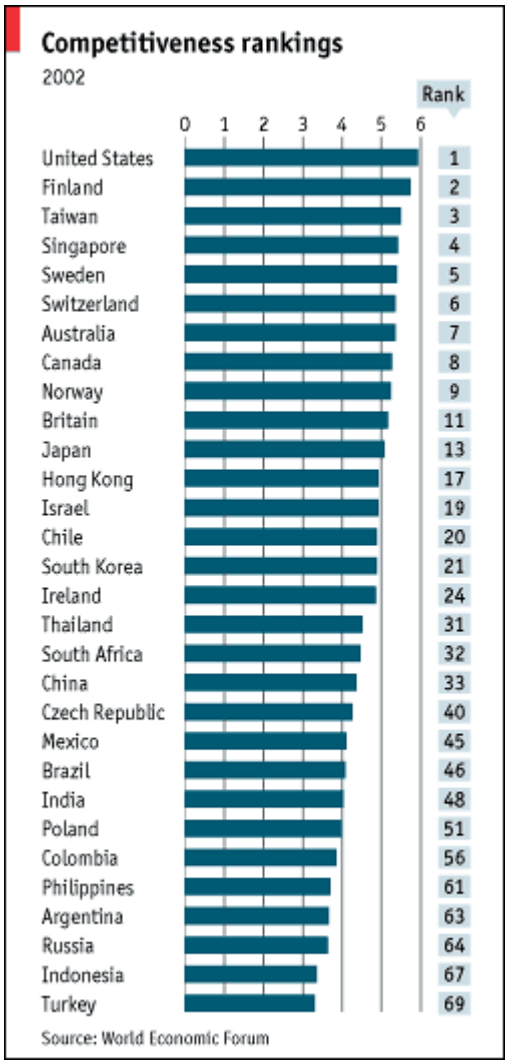
Competitiveness rankings

Nov 14th 2002
From The Economist print edition

The United States has the most competitive economy in the world, according to the World Economic Forum's most recent *Global Competitiveness Report*. The report constructs a "growth competitiveness index" for 80 industrialised and emerging economies. The index includes several factors that influence a country's economic prospects over the next five to eight years, such as technology, public institutions and the macroeconomic environment. America's strong performance in technology, and particularly in research and development, in collaboration between universities and business, and in the level of tertiary education, helped to put it in first place.



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Economy

Nov 14th 2002
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 8.1	Q3	+14.2	Oct	– 0.8	Oct	+30.0	Oct	+17.4	2001	258.6	Sep
Hong Kong	+ 0.5	Q2	–11.2	Q2	– 3.7	Sep	– 7.6	Sep	+15.7	Q2	110.6	Oct
India	+ 6.0	Q2	+ 6.1	Sep	+ 4.3	Sep	– 5.5	Sep	+ 2.0	Q2	60.7	Oct
Indonesia	+ 3.5	Q2	–11.7	Q1	+10.3	Oct	+26.6	Sep	+ 6.1	Q1	29.2	Sep
Malaysia	+ 3.8	Q2	+ 9.0	Sep	+ 2.1	Oct	+12.8	Sep	+ 6.9	Q2	33.9	Sep
Philippines	+ 4.5	Q2	–12.0	Aug	+ 2.7	Oct	+ 2.6	Aug	+ 6.1	Jul	13.1	Oct
Singapore	+ 3.7	Q3	+10.4	Sep	– 0.4	Sep	+ 7.5	Sep	+17.5	Q2	81.4	Oct
South Korea	+ 6.3	Q2	+ 3.4	Sep	+ 2.8	Oct	+10.7	Oct	+ 5.2	Sep	116.0	Sep
Taiwan	+ 3.0	Q2	+12.5	Sep	– 1.7	Oct	+17.8	Oct	+24.8	Q2	157.6	Oct
Thailand	+ 5.1	Q2	+ 9.8	Sep	+ 1.4	Oct	+ 3.8	Sep	+ 6.9	Sep	36.8	Sep
Argentina	–13.6	Q2	– 3.8	Sep	+39.4	Oct	+14.9	Sep	+ 3.9	Q2	9.4	Sep
Brazil	+ 1.0	Q2	+ 5.6	Sep	+ 8.5	Oct	+11.2	Oct	–13.1	Sep	38.4	Sep
Chile	+ 1.7	Q2	+ 5.2	Sep	+ 3.0	Oct	+ 2.2	Sep	– 0.6	Q2	14.7	Sep
Colombia	+ 2.2	Q2	+ 1.0	Aug	+ 6.4	Oct	+ 0.5	Aug	– 1.3	Q2	10.6	Sep
Mexico	+ 2.1	Q2	– 0.6	Sep	+ 4.9	Oct	– 8.9	Sep	–16.3	Q2	46.6	Sep
Peru	+ 3.8	Aug	+ 4.8	Aug	+ 1.4	Oct	+ 0.2	Aug	– 1.0	Q2	9.3	Sep
Venezuela	– 9.9	Q2	– 6.6	Jul	+29.9	Oct	+ 8.5	Q2	+ 1.9	Q2	8.2	Sep
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 3.0	Sep	– 7.9	Jul	nil	Q2	13.0	Jun
Israel	– 1.7	Q2	– 2.8	Aug	+ 6.4	Sep	– 6.4	Oct	– 2.6	Q2	24.4	Oct
South Africa	+ 2.2	Q2	+ 8.6	Sep	+12.5	Sep	+ 3.1	Sep	– 0.3	Q2	5.9	Sep
Turkey	+ 8.2	Q2	+10.8	Sep	+33.4	Oct	–11.4	Aug	+ 1.1	Aug	25.1	Sep
Czech Republic	+ 2.5	Q2	+ 9.2	Sep	+ 0.6	Oct	– 3.1	Sep	– 2.3	Q2	22.5	Oct
Hungary	+ 3.1	Q2	+ 8.1	Sep	+ 4.9	Oct	– 2.9	Sep	– 2.7	Sep	10.1	Sep
Poland	+ 0.8	Q2	+ 6.7	Sep	+ 1.3	Sep	–10.3	Sep	– 6.6	Sep	28.2	Sep
Russia	+ 4.1	Q2	+ 5.5	Sep	+14.9	Oct	+42.9	Sep	+27.6	Q3	43.0	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 2.8	May	+ 3.5	Oct	– 1.2	Oct	+ 2.7	2002†	6.4	Sep
Saudi Arabia	+ 1.2	2001	na		– 1.1	Jul	+44.1	2001	+14.5	2001	17.8	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Nov 14th 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 13th		Dec 31st 2001	
	Nov 13th	year ago	Nov 13th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.1	na	1,557.8	-3.9	- 9.0	- 9.0
Hong Kong	7.80	7.80	12.4	1.56	9,616.6	-1.6	- 15.6	- 15.6
India	48.3	48.1	76.6	5.51	2,960.7	-0.7	- 9.2	- 9.3
Indonesia	9,047	10,645	14,355	13.87	367.1	-0.6	- 6.4	+ 7.6
Malaysia	3.80	3.80	6.03	3.10	646.9	-1.8	- 7.1	- 7.1
Philippines	53.2	52.1	84.4	6.88	1,059.5	- 0.1	- 9.3	- 12.0
Singapore	1.77	1.83	2.80	0.81	1,394.8	- 3.7	- 14.1	- 10.2
South Korea	1,202	1,279	1,907	4.91	653.9	- 4.2	- 5.7	+ 3.0
Taiwan	34.5	34.4	54.8	1.95	4,671.8	-1.1	- 15.8	- 14.7
Thailand	43.3	44.4	68.7	1.95	343.7	-2.9	+ 13.1	+ 15.6
Argentina	3.53	1.00	5.59	12.30	456.9	+6.9	+ 54.7	- 56.1
Brazil	3.66	2.54	5.81	20.90	9,763.7	+0.6	- 28.1	- 54.6
Chile	709	687	1,125	2.76	4,764.9	- 1.4	- 11.7	- 17.7
Colombia	2,722	2,305	4,319	7.91	1,426.3	- 3.4	+ 33.2	+ 11.4
Mexico	10.27	9.24	16.3	7.79	5,813.4	-4.1	- 8.8	- 18.6
Peru	3.60	3.44	5.71	3.95	1,268.7	+0.5	+ 7.9	+ 3.3
Venezuela	1,357	744	2,152	22.00	7,672.6	+0.2	+ 16.8	- 34.8
Egypt	4.64	4.26	7.35	6.63	5,141.7	-1.9	- 2.5	- 3.7
Israel	4.69	4.23	7.44	6.40	329.7	-2.0	- 26.2	- 30.6
South Africa	9.8	9.67	15.6	13.60	9,643.8	nil	- 7.6	+ 12.7
Turkey	1,628,000	1,542,250	2,583,148	42.00	12,417.1	+3.7	- 9.9	- 19.5
Czech Republic	30.4	37.6	48.3	2.78	440.2	+1.2	+ 11.6	+ 30.4
Hungary	237	283	375	9.59	7,475.2	+ 0.6	+ 4.8	+ 21.8
Poland	3.95	4.10	6.26	6.92	13,824.6	- 0.1	- 0.7	- 0.6
Russia	31.8	29.7	50.5	21.00	353.2‡	+1.5	+ 41.8	+ 35.8
EMF (MSCI)*	1.00	1.00	1.59	na	292.8	+ 0.9	na	- 7.8
EMBI+†	1.00	1.00	1.59	na	216.2	+1.1	na	+ 7.9

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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